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Business Week

January 8



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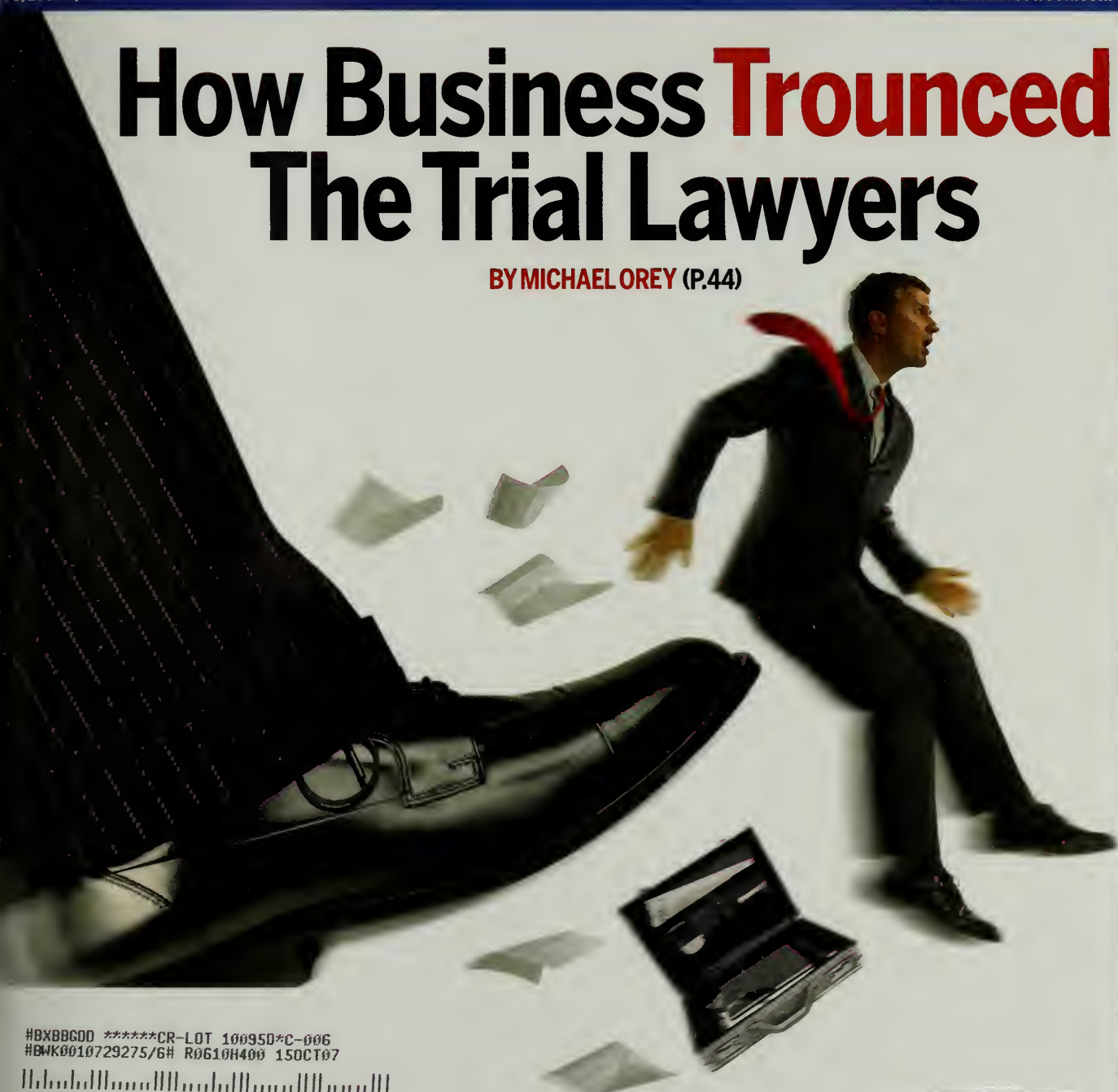
BusinessWeek

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How Business **Trounced** The Trial Lawyers

BY MICHAEL OREY (P.44)



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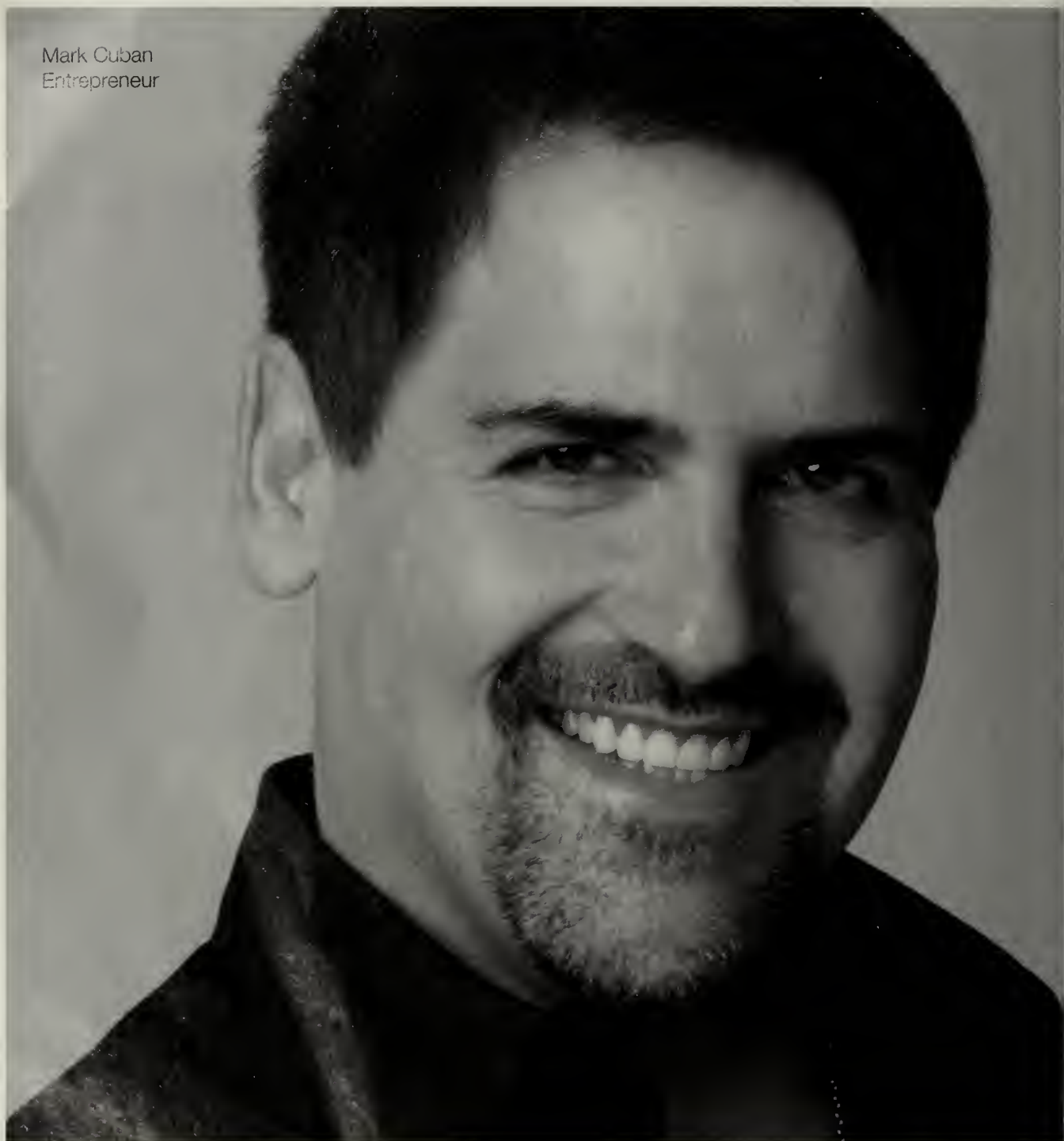


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The Business Week

News You Need to Know

so-happy holidays for retailers;
and Toyota; options; a big victory
elecoms

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The Return of the Tech IPO

7 will be the best year since 2000 as
e emboldened startups go public

The Secret Weapon at Boeing

coming business in cargo planes has
d sales as competitor Airbus struggles

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new chair of the House Financial
ices Committee is ready to deal

A Little Blue Pill for Women?

erman drugmaker may have
nbled on the female Viagra

Music to the Street's Ears

concert promoter Live Nation is on a roll,
2006 may be a tough act to follow

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ong economic growth and a hot stock
rket have foreign investors pouring
ions into the subcontinent

Gaming's Golden Oldie

y's PS2 is likely to outsell new-
eration consoles such as PS3 and
well into 2008

China's Czech Factories

resence in Central Europe creates
ter access to EU markets

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additional insights into European
Asian business, please go to
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economics

Business Outlook

Cooper says the Fed's inflation
rs are overstated, but Wall Street is
likely to get lower rates

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Cover Story

44 How Business Trowned the Trial Lawyers For decades
the plaintiffs' bar had the upper hand in the fight over litigation
reform. But in a little-noticed development, the business
community has turned the tide by aiming its attention—and lots
of cash—at the states. The result: Former plaintiff havens are
limiting damage awards and disallowing a wide variety of claims

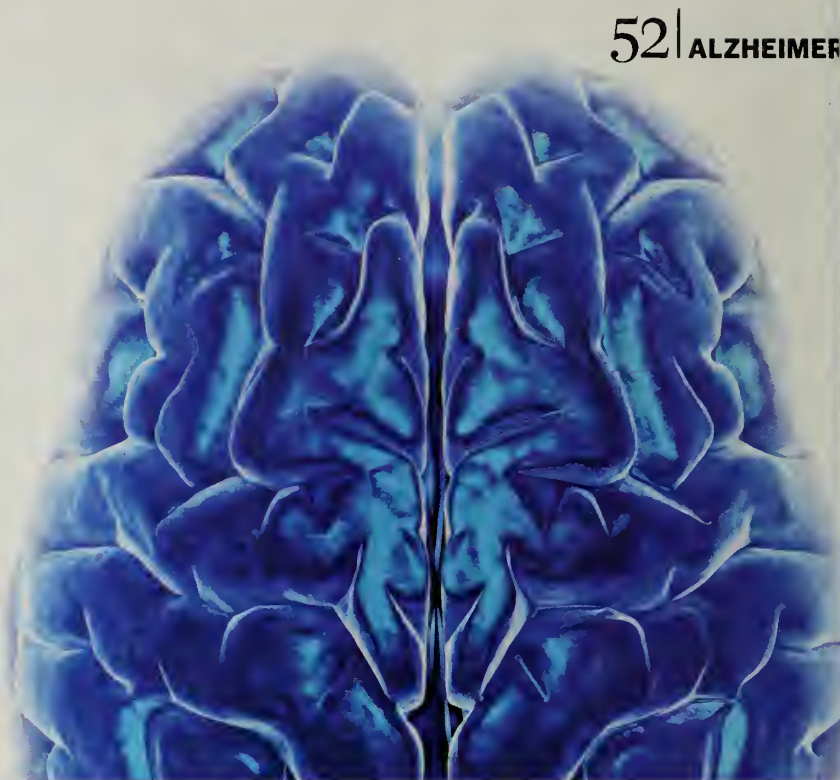


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\$60, a thief can acquire your
medical records—and then use
them to get costly health-care
services. It's a scam that has
been played on an estimated
250,000 Americans, leaving
many of them with enormous
surgical bills and lacerated
credit ratings



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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Mark Vadon, the 36-year-old president and CEO of Blue Nile

Young Turks in the Corner Office

Once upon a time the only way someone **under 40** would have wound up sitting in **the boss's chair** was if he or she inherited the family business. These days, however, more and more CEOs look like they are only a few years out of college, rather than the usual grizzled industry veterans. The reason? Investors have grown accustomed to **young visionaries** in the wake of the personal-computing revolution, led by the likes of Michael Dell, Bill Gates, and Steve Jobs. To find out about the new generation of young CEOs, BusinessWeek.com, working with Capital IQ, came up with a list of **every CEO 40 and under** running a company traded on the NYSE or NASDAQ. Our special report spotlights approximately **100 chief executives** of publicly traded U.S. companies. It's not surprising that the majority of these youthful CEOs, such as Jordan Greenhall, 35, of digital video compression software maker DivX and Jeff Stibel, 33, of Web-hosting concern Web.com, work in **the technology sector**. We were amazed and impressed to find out how many there are and who they were. You might be too. For all this and more, go to www.businessweek.com/go/07/under40

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"It was a holiday present to Corporate America."

—Ann Yerger, executive director of the Council of Institutional Investors, on a new SEC rule altering stock-option award disclosures, allowing many companies to report significantly lower total compensation for top executives, as reported by The New York Times

EDITED BY DEBORAH STEAD

ALIEN NATION REASONS TO WATCH WHOM YOU HIRE



IDS BY the feds at six **Swift Co.** plants on Dec. 19 made headlines. But they're just part of the story for companies caught in the crossfire of the immigration debate, who also face attacks from competitors and employees.

In California, a Bakersfield court is slated to hold a January hearing on a suit filed by labor contractor **Global Horizons** alleging that some employers use illegal workers, putting it at a competitive disadvantage. The suit, filed

under state antitrust law, seeks more than \$1.6 million in damages. "We want to get a judge's opinion about the legal validity of it before we file more," says David Klehm, attorney for Global Horizons. Also waiting to be heard, in federal courts: cases filed under anti-racketeering laws by workers at **Tyson Foods** and **Mohawk Industries** who claim managers conspired to hire undocumented workers to depress wages. Both companies deny the allegations.

Meanwhile, the **Immigration Reform Law Institute**, part of immigration-control group **FAIR**, is gearing up to target banks and mortgage lenders serving illegals. As the immigration debate rages, says Angelo Amador of the U.S. Chamber of Commerce, Congress "should indemnify" businesses that conduct good-faith ID checks. "We need predictability and some finality," he says.

—Richard S. Dunham



THE BIG PICTURE

RECENTLY polled employees picked New Year's resolutions for their managers. (Best cancel that team-spirit workshop.)

DEAL WITH WORKPLACE CONFLICTS FASTER:	18%
BE LESS OF A MICROMANAGER:	14%
RECOGNIZE WORK WELL DONE:	12%
PLAN EVENTS FOR BUILDING OFFICE MORALE:	0%

Source: Development Dimensions International Inc.



WEB WATCH

Wiki's Search For Tomorrow

CAN THE WISDOM of crowds trump the power of Google? Jimmy Wales (above), the man behind **Wikipedia**, thinks so. Wales plans to launch **Wikiasari**, a search engine, in early 2007. Like his Web encyclopedia, one of the top 15 online destinations worldwide, Wales's engine will rely on input from a volunteer community—this time to re-rank search results and (if users have the programming chops) to tweak Wikiasari's open-source search codes for better results. Used alone, Wales argues, mathematical search formulas like Google's do not produce consistently relevant results. "Human intelligence is still a very important part of the process," he says.

Unlike Wikipedia, Wikiasari will be for-profit, funded by Wales's **Wikia Inc.** and **Amazon.com**, plus \$4 million from **Bessemer Venture Partners**, an original Skype investor, and **Omidyar Network** (owned by Pierre Omidyar, founder of eBay). Wales, who believes potential contributors won't balk at helping out an ad-sponsored, profit-making search wiki, figures it will take three years of user input before Wikiasari can rival the top engines. "I wish I could write a Google-killing project in three months," he says, "but it is going to take a little bit longer."

—Catherine Holahan

YEAR OVER YEAR

Granted, it's not "the view from 40,000 feet" (see Item 6). But a look at some of the changes over the past 12 months can reveal a pattern or two. Here, the blips that popped up on our radar.

Eclectic Indicators

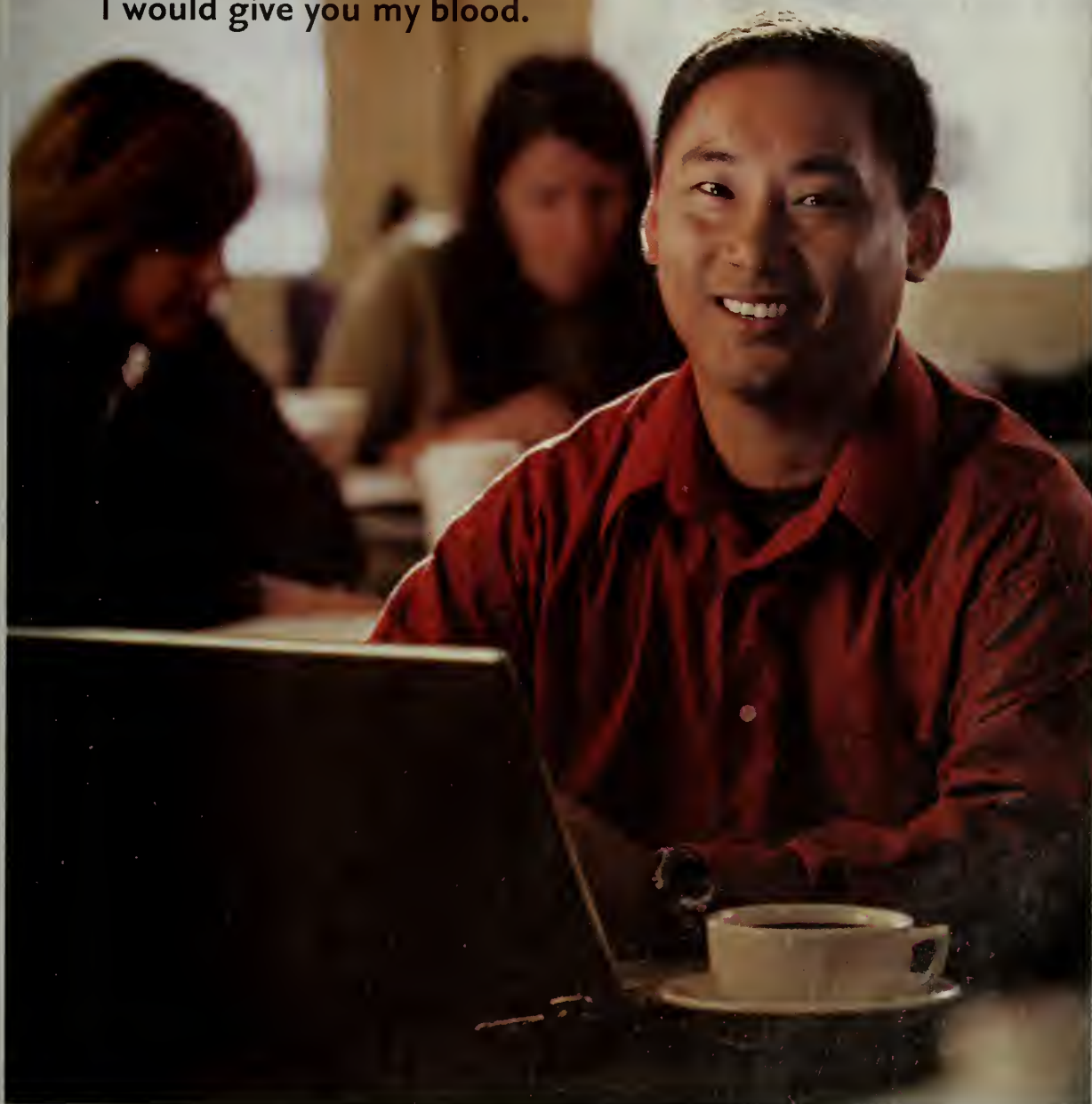
2005 2006

1. Google employees	4,989	9,378
2. Top three Google News search terms	Janet Jackson, Hurricane Katrina, tsunami	Paris Hilton, Orlando Bloom, cancer
3. Wikipedia articles	2.5 million	5.3 million
4. Real-life companies in virtual community Second Life	2	43
5. Blogs worldwide	20 million	57 million
6. Business jargon deemed "most dreadful" by Buzzwhack.com	"client-centric"	"leverage our assets"
7. Criminal antitrust fines obtained by Justice Dept.	\$338 million	\$473.5 million
8. Shareholder resolutions on capping executive pay	2 (of 1,058 resolutions)	11 (of 1,029 resolutions)
9. Resolutions on shareholder majority (vs. plurality) to elect directors	84	149
10. New private jets shipped	711	822
11. Percent of full-time MBA programs reporting rise in applications from year earlier	21%	65%
12. Portion of U.S. corn crop used for ethanol	14% (1.4 billion bushels)	19% (about 2 billion bushels)
13. "Most recalled" product placement in a TV episode	Buick, <i>Desperate Housewives</i>	iPod, <i>House</i>



Data: 1. Google 8K filings in September of both years. 2. Google. 3. Wikipedia (as of September, both years). 4. Linden Lab. 5. Technorati (as of October, both years). 6. Buzzwhack.com (Websi poll, 2006; editor's choice, 2005). 7. Justice Dept. (for fiscal years ending in September) 8. & 9. Institutional Shareholder Services. 10. Teal Group; figures are worldwide (U.S. two-thirds of global market). 11. Graduate Management Admission Council. 12. National Corn Growers Assn.; 2006 percent of total is projection. 13. IAG Research; episodes on Jan. 9, 2005 and Nov. 14, 2005.

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REALITY CHECK

AT LEAST NO ONE PREDICTED PEACE IN THE MIDDLE EAST

Karl Rove, Howard Stern, and eBay's Meg Whitman weren't just a little off about 2006. They were flat-out wrong. So were some housing analysts and government meteorologists. Now that the season for good will has passed, let's gloat over some of the forecasts that fizzled.

PREDICTION: "We are on a tear to be the undisputed winner in China."

—eBay CEO Meg Whitman, Feb. 10, 2005

THE REALITY: In December, 2006, eBay said it would close its eBay operation in China and become instead the junior partner in a new Chinese e-commerce venture.

PREDICTION: Satellite radio will succeed.... Trust me. With me, it's a lock."

—Howard Stern, Dec. 22, 2005

THE REALITY: The stock of Sirius Satellite Radio, Stern's new employer, is down more than 40% since he began broadcasting. In the first nine months of 2006, Sirius lost

nearly \$900 million.

PREDICTION: Patricia Dunn is the "clean-up queen of corporate governance."

—Headline in *The Age*, Melbourne, Australia, Apr. 4, 2006

THE REALITY: On Oct. 5, Dunn, Hewlett-Packard's former board chairman, was booked in California's Santa Clara County Superior Court following felony charges arising from HP's alleged spying tactics in its investigation of boardroom leaks.

PREDICTION: "A very active hurricane season is looming."

—National Oceanic & Atmospheric Administration, May 22, 2006

THE REALITY: Of the up to six "major" hurricanes in the North Atlantic that were predicted by NOAA, only two materialized. Number that reached U.S. shores: zero.

PREDICTION: "It's very clear to us that oil prices have peaked for this cycle."

—Bill Miller of Legg Mason, Dec. 8, 2005

THE REALITY: Miller, the firm's leading investor, said oil prices would reach \$40 to \$55 a barrel during the year. Instead, they hit \$78 in 2006.

PREDICTION: The national median home price will rise about 6.1% in 2006. Over a full year, it "has



never declined since good record-keeping began in 1968."

—National Association of Realtors, Dec. 12, 2005

THE REALITY: Through October, the median price of residential properties was down 3.5% from a year earlier.



PREDICTION: "It's the definitive last chapter in the trial of the century."

—Fox Broadcasting Executive Vice-President Mike Darnell, on O.J. Simpson's book, *If I Did It*, Nov. 13, 2006

THE REALITY: It wasn't the last chapter; it was the last straw. After a public uproar, News Corp. Chief Executive Rupert Murdoch killed the book and fired its editor, Judith Regan.

PREDICTION: "Earnings disappointments will likely cause a more significant correction in equities at some point in 2006 than we have experienced in some time."

—Robert Doll, chief investment

officer of Merrill Lynch Investment Managers, Jan. 10, 2006

THE REALITY: Corporate earnings reached their biggest share of gross domestic product since 1950, the market never "corrected," and through Dec. 20, 2006, the S&P 500 stock index was up 14%.

PREDICTION: "There's just not that many videos I want to watch."

—Steve Cooney, co-founder of YouTube, worried in March, 2006, about his start-up's potential popularity

THE REALITY: As of

Nov. 14, 2006, YouTube was expressing all this anxiety. YouTube had roughly 50 videos available. Today more than 100 million are viewed daily on YouTube, which was acquired by Google on Nov. 14 for \$1.65 billion.

PREDICTION: "I'm looking at all these [polls]...and adding them up. I add up to a Republican Senate and a Republican House. You may end up with a different math, but you are entitled to your math, and I'm entitled to THE math."

—Presidential adviser Karl Rove, Oct. 24, 2005

THE REALITY:...was rather different.

—Peter C.





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OUTLOOK: UNLIKELY

Bruce McCall's Forecast 2007

Wal-Mart's dreamed-of merger with Habitat for Humanity International may finally happen in 2007. And why not? It's an exchange of pluses analysts say can't miss: The big-box retailer, down in the image dumps, gets to bask in Habitat's goody-two-shoes rep—and take on an all-volunteer workforce to build its new megastores. Access to Wal-Mart's competitive culture, meanwhile, should help nonprofit Habitat hold on to its share of the cutthroat market in building homes for the poor free of charge.



Overseas Now that the last of its dissident shareholders have vanished, Russia's oil-weapons-vodka cartel, MuzGop, looks likely to spin off its chronically underperforming Government unit. Among the rumored buyers: Hot leveraged-buyout firm DZERZH, made up of former KGB officers.

2007 should also be the year MegaMicro finally starts to ship its LifePod 4G, designed to pack your entire existence into a slickly styled, thimble-size gizmo that lets you replay, over and over, every moment you've lived, from first kiss to your niece's bat mitzvah and that last visit to the dentist. Let's hope that what kept the 4G in beta for all these years—the pesky electronic glitch that short-circuited the system and erased 15 focus-group participants in 2003—has been licked.

U.S. Industry is a cinch to go big-time for SludgeCo's new line of enviro-friendly pollutants, due out on Earth Day. Already generating lots of excitement: river contaminants that poison water rats while actually strengthening the delicate vascular system of the snail darter.

Airlines will once again take the lead in cost-cutting ingenuity. CrisisAir's bold bring-your-own-seat program starts in February. And to save on fuel costs, Air

Chapter Eleven will inaugurate "tow trips"—lead passenger jets pulling two or three other planes across the sky lanes. Over at Trans Insolvent, meanwhile, they're dispensing with their fleet altogether. Starting in '07, TransIN will rent small private planes on the spot at its hubs and divvy up the passenger load, taking air travel back to the romantic barnstorming era.

Finally, expect more companies to hop on the back-to-basics brand-name bandwagon.

EmGarCo will revert to Emmett Garver Stationers come January. Maxicia will hang out its old Jones Bros. Home & General Insurance shingle. And Neoxibat? It will once more be simple-as-pie Nelson Oxide Battery Corp.



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“If it’s truly possible to do a day’s work from your bed or your home, then it’s also possible to do the work in India or China.”

—Tom Russell
 Forest Hills, N.Y.



THE PROS AND CONS OF FLEX-TIME

I HOPE “SMASHING the time clock” (Cover Story, Dec. 11) will hasten the death of business’ insidious face-time culture. As an academic in a results-oriented work environment (ROWE), I consider this to be the greatest aspect of my professional life.

My research and much of my professional service can be performed anywhere and any time, such that only class time, office hours, and occasional meetings are not flexible. I work hard, but on my terms, and I believe that my productivity is greatly enhanced as a result. My family also appreciates that I rarely miss the kids’ events even if they are at 11 a.m. on a Wednesday. Of course, I sometimes work until 1 a.m. at home to meet my goals. I wish more people could enjoy this degree of flexibility, as I believe that both businesses and families would benefit.

—Dana R. Hermanson
 Kennesaw State University
 Kennesaw, Ga.

YOUR ARTICLE DOES more than tell the reader about Best Buy Co.’s work

environment. It reveals the basis of Best Buy’s lack of accountability and poor customer service.

—Jerome Want
 Organization Strategies International
 McLean, Va.

THE LACK OF fixed schedules at Best Buy cannot exist in the long term in a competitive global economy. If it’s truly possible to do a day’s work from your bed or your home, then it’s also possible to do the work in India or China. The irony of the advent of the Internet and “working from home” is that jobs that require significant face time and physical presence are all the more valuable.

—Tom Russell
 Forest Hills, N.Y.

WITH ALL DUE respect to Best Buy, are you off your rocker? The company’s ROWE program sounds awesome—if we were all a collection of independent contractors with task-specific jobs in front of us. I’ve worked in management positions at several midsize-to-large corporations (including my current one at a national competitor of Best Buy), and the divisions I’ve managed don’t live or die by an

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Corner Office



individual effort. They succeed based on the work of the team.

Yes, you can design metrics that measure team success, but can you design metrics that measure the effect of one member needing a quick answer from another and having to chase them down because they don't know whether they're going to be in the office or at a movie?

—Todd Maddison
Oceanside, Calif.

THE MORTGAGE BEAT HAS PLENTY OF COPS

"A FAREWELL TO ARMS? Not quite yet," (News & Insights, Dec. 11) was not fully accurate. I agree that the increased marketing of option ARMs has given financial regulators cause for concern, and they have acted to alleviate the risks these products can have for consumers. But the Office of the Comptroller of the Currency (OCC) has not acted independently, as your article states.

Instead, the federal financial agencies released interagency guidance on nontraditional mortgage product risks on Sept. 29, which applies to all insured depository institutions and affiliates. The Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators issued parallel guidance, which applies to state-licensed mortgage brokers and lending companies and has been adopted by 19 states and the District of Columbia. On Dec. 13 the Office of Federal Housing Enterprise Oversight directed Fannie Mae and Freddie Mac to follow the guidance.

I agree that residential mortgages are increasingly originated by "new players" not regulated by the OCC. Yet in addition to regulating banks, 49 states plus the District of Columbia currently provide regulatory oversight of those mortgage companies that originate, fund, and, in some states, service mortgage loans, including REITs and private-equity players. The exception is Alaska, which is expected to adopt legislation in 2007 enabling it to license mortgage providers. State supervision of the mortgage industry is evolving to keep pace with the rapid changes in the marketplace.

—Neil Milner
Conference of State Bank Supervisors
Washington

NO WONDER GENERAL MOTORS IS IN TROUBLE

G. RICHARD WAGONER must not be too serious about improving the im-

age of General Motor Corp.'s pro quality. In "Wagoner's fighting chair" (News & Insights, Dec. 11), he is photographed in a car with trim on driver's side door that does not pop up properly. If the CEO of GM can't get a car with good fit and finish, who can?

—Paul H. Griener
Rochester, N.Y.

Editor's note: The vehicle shown is a GM Chief Executive Rick Wagoner's pre-production model used for photography only.

CORRECTIONS & CLARIFICATIONS

"Habitat for hustlers" (News & Insights, Nov. 20) should have identified the Williams couple as Theodore and Louise. Also, it should have noted that Habitat for Humanity International and EverBank have multiple work-out options for homeowners who are in financial trouble and that it can take several years of counseling and payment restructuring plans before a foreclosure is pursued.

"Napping your way to the top" (Executive Life, Nov. 27) incorrectly stated that Deloitte Consulting encourages employees to add a midday nap to their list of tasks. The company does not encourage employees to nap during business hours.

"Biggest reality bite" (The Best and Worst of 2006, Dec. 18) stated that annual sales growth for Whole Foods Market fell into the single digits in 2006. In fact, the company says it expects annual sales to have increased 19.3% in 2006. Also, the article should have said that CEO John Mackey's age is 53, not 52. BusinessWeek regrets the errors.

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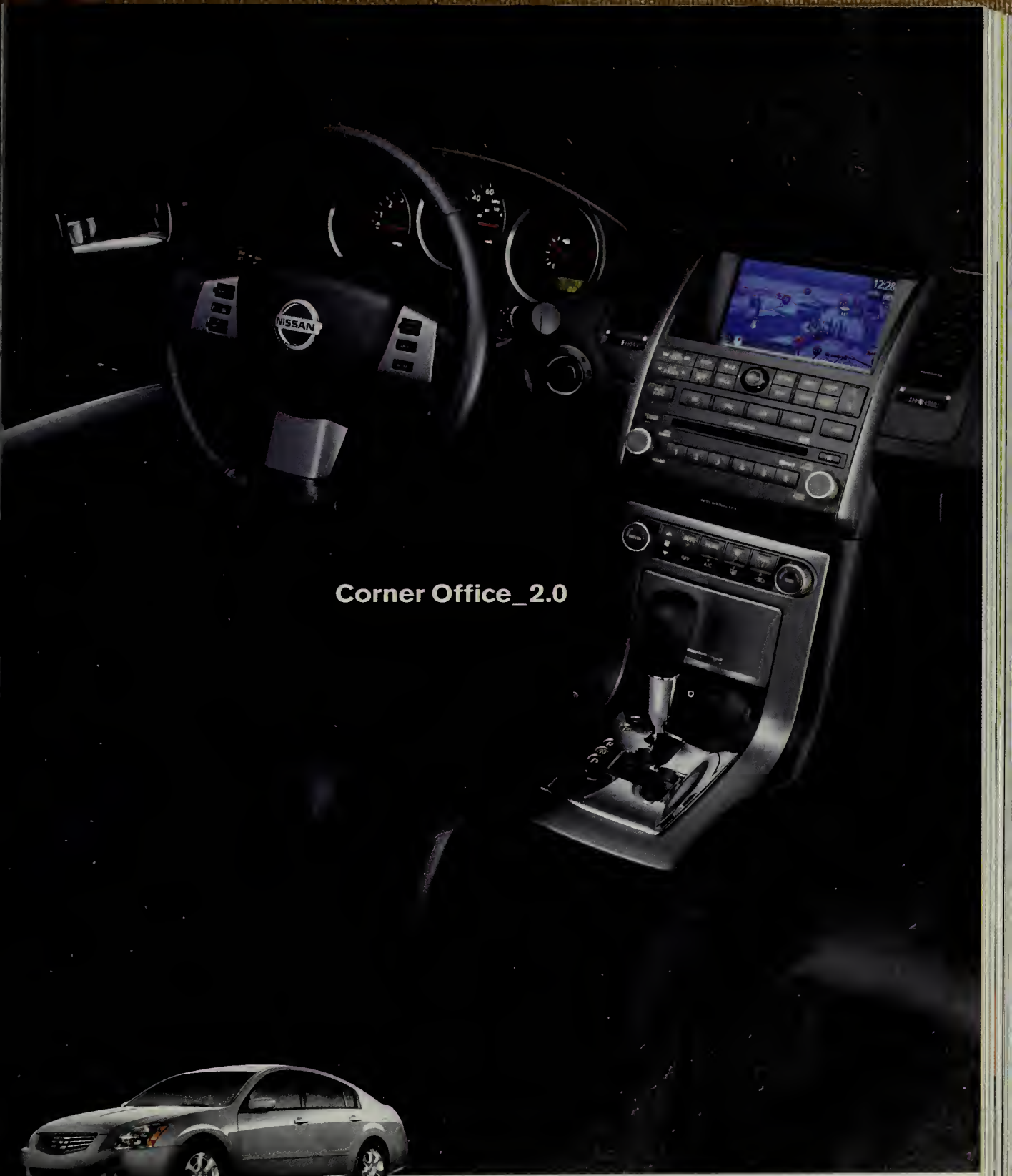
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Microsoft's Remodeled Office

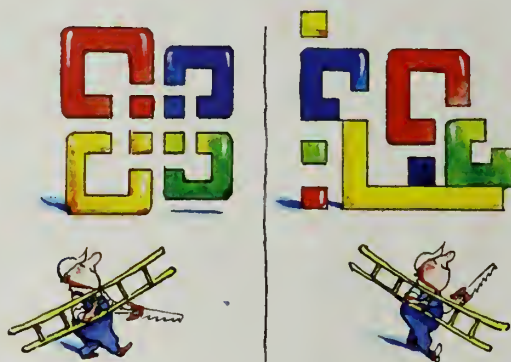
Longtime users of Microsoft Office are in for a shock when they get their first look at the new version, which goes on sale Jan. 30. Almost everything familiar about Word, Excel, PowerPoint, and other programs has changed. It's not a bad face-lift, on the whole, but there are important issues to consider before you upgrade to the new suite.

On the plus side, the design is clean and intuitive. Drop-down menus have been replaced by a command "ribbon," a sort of super-toolbar that shows the commands appropriate for the task at hand, such as entering text, reviewing a document, or inserting an illustration. In the old Office, when you were working in Word, commands related to formatting were scattered among the File and Format menus, various toolbars, and the Styles and Formatting task panel. The new version makes them all available on the Page Layout ribbon.

I like this approach, but there's a trade-off: A lot of users have grown adept at Office, which has changed little in the 20 years since it was launched. Now many of us will have to relearn what we already know.

MICROSOFT SAYS OFFICE VETERANS will get up to speed after using the new programs for a few hours. I suspect that's optimistic. I found, for instance, that the References ribbon in Word simplifies tasks that were obscure in previous versions, such as creating footnotes or assembling a bibliography. But for a while, I had to fumble around looking for the Undo command, which has moved from the top of the Edit menu to a little toolbar at the top of the window. Microsoft did take two steps to make life easier for power users who have done extensive customization of programs. All of the keyboard shortcuts from previous versions still work—like control Z for "undo"—and prior customization will be applied to the new program versions upon upgrade.

The new design is consistent across all the Office programs. Excel has a "Formulas" ribbon, for example; PowerPoint has one for animations. The exception is Outlook 2007, which resembles Outlook 2003. But the window for writing a new message closely resembles Word, with a ribbon instead of menus.



Office has a nifty new look and feel, but it's not a must-have

The look and feel aren't the only things that are new in Office. For the first time since 1997, Microsoft has changed the way Office programs store their data. Instead of the familiar ".doc" ending, for example, you'll see ".docx." This indicates that the Word document adheres to an industry standard called XML, designed to facilitate the sharing of data. The new formats make it easier for programs from different companies to read and write Word, Excel, or PowerPoint files.

This change also has a downside. If you use Office 2003 or XP, you'll have to download a converter from Microsoft before you can open, edit, or save files that somebody sends you in the new formats. And by the same token, if you upgrade to the new Office, you may want to set a preference to save files in the old formats—otherwise you may have trouble sharing them with people who haven't upgraded.

Since earlier versions of Office already contained just about every bell and whistle you could imagine, there aren't a lot of new features in Office 2007. One nice touch is instant preview of a document's changed appearance as you move the cursor over a different typeface in the font list.

You'll have to decide if ribbons and other improvements are worth the learning curve—and the money. The cheapest version of Office 2007 is the \$149 Home & Student Edition. It can be installed on up to three PCs, and includes Word, Excel, PowerPoint, and OneNote, an application for taking notes. More extensive packages range from \$239 to \$679. If you are happy with your current version of Office, there's no compelling reason to rush out and buy Office 2007. ■

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Ready to Get Weird, Advertisers?

To use a **perilous form of columnist shorthand**, in media terms 2005 was the year of MySpace, and 2006 was the year of YouTube. Or maybe 2006 was the year of virtual-world site Second Life, even if its fanatically devoted audience remains small relative to the hype; *Advertising Age* recently commented that it will start writing about marketers that *aren't*

establishing presences there. I should probably apologize for bringing up these usual suspects again. But of the many factors that will decide how the ad pie is split up in '07, perhaps the biggest is how quickly these next-generation Web platforms become mainstream ad vehicles and score sizable portions of marketing budgets. (In YouTube's case, it also needs corporate parent Google to, uh, invent an ad model. That alone could boost the Web's share of advertising.) These places are already accepted as legitimate media, at least judging from what top marketing executives are saying. Then again, *The Ed Sullivan Show* once "accepted" Elvis as legit and then famously showed him only from the waist up. Can '07 be the year mainstream marketers become comfortable enough to make mainstream-sized bets on these platforms' full-Monty ways? Yes, if three things happen.

ONE: BIG MARKETERS HAVE TO RELAX about getting weird. Video ads that get the biggest online bang are those that elicit a simple three-word reaction: "What the hell?" I do not posit this approach as the be-all and end-all of Web creativity. But I now have heard of Blendtec's Total Blender and watched it in action thanks to its deadpan "Will It Blend?" series of short online videos, which pit the blender against objects such as bottles of beer or 40 pens. (Needless to say, these videos win my highest recommendation.) One pioneer in this space warns of its limits. "As this market grows up, the quote-edginess-unquote of the content will get toned down," says Matt Smith, co-founder of London-based Viral Factory, which produces faux-documentary Web video shorts with viral aspirations. Right now, though, bizarre works, and Smith points out that there is a different bar set for Web video: "We are not competing with other commercials. We compete with all the other [online] content out there."

TWO: MARKETERS MUST BE PUT AT EASE in places where consumers run a little more free than they do in, say, a car



**2007 may
be the year
they fully
embrace
the Net**

showroom. Volvo has sponsored a kind of best-of feature called "What's Your Story?" on Microsoft's MSN Spaces blog network since 2005. It lets the automaker run ad messages around spotlighted blog entries—culled from Space's gazillion blog pages by Microsoft editors who ensure Volvo isn't near anything weird. This has fostered a long-term relationship between the companies. It also points to the tension between unedited environments and marketers' concerns about being there. This tension could be eased with better technology to spot content too hot for advertisers. That, and an understanding on marketers' parts, says Nielsen BuzzMetrics CEO Jonathan Carson, that "media placement by algorithm is going to result in some margin of error."

THREE: MORE AND BETTER TARGETING A marketer's fantasy about a site like MySpace isn't reaching its massive audience but identifying and targeting a few thousand highly influential or

relevant members. This is not as easy as it sounds. "Consume generated media happens much faster than traditional media," says Carson, and in places where last month's stars can fall quickly out of fashion. There are targeting tools out there, but as of yet they're "in their infancy," explains Volvo national ad manager Linda Gangeri. She also says many more Volvo dollars would flow to these sites if concerns about safety and targeting were allayed. And so, for the new Net, an old song about online is reprising: The growth spurt may have happened, but the rewards will come when these sites have grown up. ■

BusinessWeek .com For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia.

BY JAMES C. COOPER

Why the Market Isn't Listening to the Fed

's ignoring inflation warnings, but bets on lower rates may be too optimistic

U.S. ECONOMY Wall Street and the Federal Reserve seem to have quite different views of the economy in 2007. Fed policymakers continue to send out warnings on inflation and the possibility of more hikes in interest rates. Market players aren't listening. They're not worried about inflation, and they expect the Fed to begin cutting rates

some point in the coming months. Meanwhile, investors are sitting back and enjoying the rallies that began in stocks and bonds last summer. Does Wall Street have it right?

So far, the chances look good, but both investors and the economy have a lot riding on the bet. If inflation is not as tame as the markets expect, and the Fed resumes rate-hiking, bond yields and associated long-term rates for mortgages and corporate borrowing would climb. Higher borrowing costs would worsen the housing downturn and crimp corporate expansion. Plus, any market retrenchment would cut further into household net worth at a time when stock market gains have been a buffer against the waning support home values have offered to household wealth and consumer spending. All this puts inflation smack in the middle of the outlook for the coming year, just when inflation prospects are especially unclear. Global competition remains an enormous restraint on U.S. prices, but the renewed decline in the dollar is likely to put some upward pressure on import prices. Oil and energy prices are creeping back up, but their future direction still up in the air.

Plus, economists both inside and outside the Fed are unsure just how fast the economy can grow without fueling higher prices. Productivity gains, which helped keep a lid on inflation in recent years, have slowed sharply, and efficiency gains are offering less of an offset to rising labor costs, which could spur price hikes.

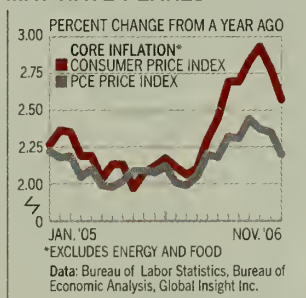
WHAT IS THE OUTLOOK for inflation really more worrisome than recent market trends suggest, or is the Fed just blowing smoke in an effort to protect its inflation-fighting credibility? The latest news from the price indexes and from data on economic growth are coming in on the side of Wall Street. However, while there is mounting evidence that additional rate increases will not be needed, there is still little indication the economy has slowed enough to warrant rate cuts. Both major gauges of consumer prices in November took a turn for the better after their upward trends throughout most of 2006. The overall consumer price index

(CPI) and the Fed's preferred measure, the price index for personal consumption expenditures (PCE), each posted no gain from October, but the core indexes, which exclude energy and food, are what got the markets' attention, since the Fed tends to watch those closely. Both core indexes also held steady from October, and the annual trends of both are now headed down (chart).

THE YEARLY INFLATION RATE for the core CPI appears to have peaked in September, at 2.9%, and it has since slid to 2.6% in November. The November softness vs. October was broad, although some price weakness, such as the declines in medical-care commodities and used cars, are unlikely to be repeated. Perhaps most significant, core service inflation, which makes up more than 70% of the core CPI, has edged down from a peak of 3.9% in September, to 3.7% in November. That's significant, since service prices tend to have a large labor-cost component, and they are more sensitive to domestic conditions and less so to global competition.

The decline in core CPI inflation is also impressive given that it has come even as

INFLATION PRESSURES MAY HAVE PEAKED



rents and the CPI's rent-based measure of housing costs continue to rise at an accelerated pace. The government measures housing costs based on equivalent rental values, which have been rising as higher home prices have made homes less affordable and rentals more attractive. This pattern has had the perverse effect of pushing up housing costs in the CPI, which account for a big chunk of the total index. In coming months, as home demand firms up, this component of the CPI will begin to slow, placing additional downward pressure on the index.

What's especially encouraging in the outlook for Fed policy and interest rates is the recent behavior of the

core PCE price index, the measure favored by the Fed. In November, yearly inflation by this gauge continued to run above the Fed's unofficial 2% limit, but the steady runup in 2006 may well have peaked at 2.4% last summer. The rate dipped to 2.2% in November, marking the largest decline from the prior month since the first half of 2003. The pattern in recent months is even more favorable. Measured at a comparable annual rate, the rise in the core PCE index over the past six months is near the Fed's 2% limit, and the annual rate over the past three months, at 1.8%, is running safely under that limit.

THE INFLATION OUTLOOK and any future Fed action will come down to the strength or weakness of the economy. Given the recent favorable shift in the price indexes, the economic slowdown that began in the second quarter appears to be creating enough slack in the economy to allow pricing pressure to abate. Economic growth slowed to a revised 2% annual rate in the third quarter, after posting a modest 2.6% advance in the second quarter, and the housing downturn and cutbacks in orders and output needed to pare down excessive inventories are keeping a lid on growth.

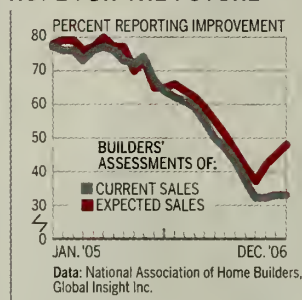
Price discounting will help to cut those inventories, and other efforts to reduce stockpiles are reflected in softer factory activity. Orders taken by manufacturers of durable goods have slowed sharply in recent months, and excluding the ups and downs in the volatile transportation sector, orders in the fourth quarter are set to decline for the first time in 3½ years. Manufacturing output is following that same track.

The economy is far from weak, however. Look at the government's numbers on consumer spending. After adjusting for inflation, outlays posted month-to-month increases of 0.5% in both October and November. Those were the strongest back-to-back gains since the middle 2005. Even if December buying shows no advance from

November, spending still will have grown at 4% annual rate from the third quarter, after only a 2.8% rise in the third quarter. That pickup will be enough to make a sizable contribution to overall growth, while helping businesses to unload some inventory.

Also, while more drag from the housing slump is on its way, the news

BUILDERS SHOW SOME HOPE FOR THE FUTURE



on home demand is looking better. Sales of new single-family homes rose in November, reducing the inventory of unsold homes to a 6.3 month-supply, the fourth monthly decline in a row. And in December, builders' expectations of sales over the next six months continue to rise (chart).

Heading into 2007, both inflation and economic growth are behaving pretty much as the Fed would like. If those trends continue, which looks likely, then investors stand a good chance of adding to their 2006 gains without fear that the Fed will spoil the party. ■

SMALL BUSINESS

Just When Hopes Were High

SMALL BUSINESSES are losing confidence as the economy continues to soften. A slower pace of economic growth in the U.S. is translating into reduced sales and income, which is likely to cause smaller businesses and entrepreneurs to reduce hiring and capital spending early in 2007.

A weekly survey of businesses by Moody's Economy.com shows that confidence among those with under 600 workers is at a three-year low. Smaller businesses have been feeling less confident than large companies since early December, after expressing greater optimism for more than a year.

There are several reasons for the rapid fall in confidence

among small businesses. The housing recession is having a large impact on small businesses. "A higher proportion of hard-pressed construction and real estate businesses are proprietorships," says Mark Zandi, chief economist at Moody's Economy.com. Plus, large businesses typically see a larger chunk of their earnings come from

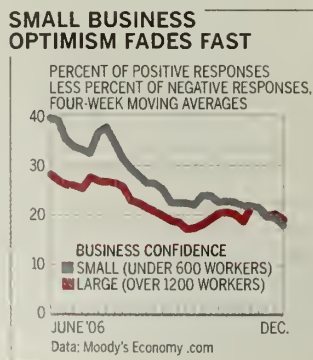
abroad, where economic growth is holding up well and the weaker dollar is boosting profits in dollar terms.

These differences are showing up in other data. Through November, income among sole proprietors is on track to grow 2.7% from a year ago in

the fourth quarter. That would be the smallest gain since early 2003, and contrasts with the resilience shown in corporate profits. The monthly survey of small businesses by the National Federation of Independent Business showed a greater share of respondents reported declines in earnings during the three-month period through November. Sales also appeared to ease over the period.

The erosion in conditions and confidence among small businesses could affect economic activity next year. Fewer small businesses are now making capital investments compared to the first half of 2006. Softer profit and proprietors' income foreshadows weaker hiring later on, says Zandi. That implies weaker job growth as small businesses scale back, leaving their bigger cousins as the primary sources of hiring.

—By James Mehring in New York



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EDITED BY HARRY MAURER



What Happened to Santa? Retailers are going into damage-control mode as the holiday numbers come in. Same-store sales at major retail chains inched up 1.7% in the week ending Dec. 23, compared with a year earlier, according to a survey that the **International Council of Shopping Centers** released on Dec. 27. **MasterCard** estimated that retail sales from the day after Thanksgiving to Dec. 24 rose by 3% over the same period last year. (Chicago shoppers, photo.)

Still, merchants have some cause for cheer. Gift cards, which don't count as sales until they're cashed in, could give a lift to post-holiday revenue, aided by sharp price cuts. More important, real wages for low- and middle-income workers finally are showing signs of rising after three years of stagnation. That trend, if it continues, would be good news for **Wal-Mart** and other discount chains, which have struggled along with their customers.

ONLINE See "A ho-hum holiday for retailers," www.businessweek.com/go/tbw

Auto Titan Tête-à-Tête The car industry is ending 2006 the way it spent most of the year: obsessing about hookups between leading players. The Dec. 20 hush-hush meeting in Japan between new **Ford CEO Alan Mulally** and **Toyota Chairman Fujio Cho** sparked brief excitement on Wall Street about a possible alliance. Ford would benefit from close contact with its rival's ultra-efficient production system and hybrid technology. Toyota could gain political cover as it prepares to surpass **General Motors** as the world's

largest automaker next year. Both companies say high-level meetings are an industry fixture. And analysts doubt a long-term tieup is on the table.

ONLINE See "And now: Ford and Toyota" www.businessweek.com/go/

About-Face on CEO Pay As companies get set to close new details on executive pay, the **SEC** issued an 11-hour rule change on reporting stock options. In a Dec. 20 notice, the commission instructs companies to spread value of options grants to executives over several years: the options vest, rather than reporting the grand total in the year they were awarded, as the SEC ruled in July. The swap prevents reporting anomalies resulting from large, one-time grants and is more in line with accounting standards, the commission says. Investors fret it could keep them in the dark about which bosses are bagging the most dough.

Options Watch Is **Steve Jobs** worried? That's the question following reports that the **Apple** CEO has retained outside legal counsel because of the investigation into options backdating. A Dec. 26 report in *The Recorder*, a California legal journal, says federal prosecutors are looking at possibly falsified options awards documents uncovered as part of an internal probe. Two former execs, **ex-general counsel Nancy Heinen** and **ex-CFO and director Fred Anderson**, have each hired counsel. An Apple spokesman declined to comment, but the company is expected to file long-delayed quarterly and annual reports with the **SEC** by yearend.

ONLINE See "Apple Weighing the Options" www.businessweek.com/go/

Look Out, Cable Guys Big telecom outfits just won a victory. Imposing a rule that will benefit the likes of **AT&T** and **Verizon**, the **FCC** voted on Dec. 20 to bar local governments from "unreasonably refusing" to grant TV franchises to new competitors. The 3-2 party-line decision would in many cases force municipalities to accept or reject a proposal for a new carrier within 90 days and strikes down local requirements that telcos say had favored incumbent cable providers. If Congress lets it stand, the rule will make it easier for Baby Bells to move into the boob tube biz.

Shell Says Uncle In Russia, whatever **Gazprom** wants, **Gazprom** tends to get—including a 50%-plus-one-share stake in the \$20 billion **Sakhalin II** oil-and-gas project. **Royal Dutch Shell**, which had 55%, and its Japanese partners, **Mitsubishi** and **Mitsubishi**, each sold the state-controlled gas giant 1% of their shares for a lowball price of \$7.45 billion. A **Shell** spokesman termed the Dec. 21 settlement "acceptable."

Bristol-Myers' Babysitters This deal probably went down like castor oil, but on Dec. 21, **Bristol-Myers Squibb** said it would pay \$499 million to settle investigations by the Justice Dept. and Massachusetts regulators into marketing practices. It's the biggest such payment to date in a wide-ranging inquiry into pharmaceutical pricing and

...s. Besides ponying up the fine, the drugmaker will allow
feds to monitor its regulatory compliance and training
actices. That "corporate integrity agreement" comes in
ition to a Justice monitor who keeps tabs on operations
he result of an earlier settlement. BMS continues to be
ged by several state investigations and a class action.

Branson: He's No Yank Virgin America's takeover was
ayed on Dec. 27 as the **Transportation Dept.** ruled that the
rier wasn't under control of U.S. citizens, as required by
. The ruling said **Sir Richard Branson's Virgin Group** would
e "pervasive involvement," citing interlocking financial
reements and Virgin Group's ability to influence the
ine's board. Domestic carriers fought to shoot down Vir-
America's application. The airline says it'll take another
ck at demonstrating its U.S. bona fides.

Bidding War in India It's only India's fourth-larg-
mobile telco, but in just three days, from Dec. 20 to 23,
Hutchison Essar's projected price tag jumped from \$14 billion
\$17 billion. Hong Kong's **Hutchison Whampoa** now owns
6, with Indian conglomerate **Essar** holding the balance.
e callers include the second-largest Indian telco, **Reliance**
Communications, a clutch of private equity players, British gi-
Vodafone, and Egypt's **Orascom**. Every now and then, even
ar makes noises about wanting to buy out its partner.

ONLINE See "Vodafone and India's vast potential,"
www.businessweek.com/go/tbw

Memoriam Frank Stanton, who along with his boss,
William Paley, built **CBS** into the preeminent network of the
ty days of television, died on Dec. 24.

A President's Passing

Remember those **WIN** buttons? **President Gerald Ford**, who
ed on Dec. 26 at age 93, unveiled them with the rally-
g cry "Whip Inflation Now" back in 1974—a reminder
at the Watergate scandal was not the only crisis **Richard**
Nixon left Ford when he resigned. Ford also inherited
gh inflation and a stagnant economy. In a speech that
ll, the former Michigan congressman declared infla-
on "public enemy No. 1" and asked **Treasury Secretary**
William Simon and top economic adviser **Alan Greens-**
pan to help tame the beast. Ford's policies squeezed
inflation from 11% to 5%, but
higher joblessness (from 5.6% to
7.7% in 1976) cost him politically.
Democratic challenger **Jimmy**
Carter coined the term "misery
index" (unemployment plus in-
flation), and it stuck. Ford may
have whipped inflation, but he
couldn't whip Carter. Ford later
served as a director at **Citigroup**
and an advisory director at **Ameri-**
can Express, among other boards.



FORD IN 1976

Sprint's mobile broadband connects you in 350 more airports than Cingular's.

Get the power of the
nation's largest mobile
broadband network.



PX-500 by Pantech™

Now you can download huge files and
attachments instantly from anywhere
on the nation's largest mobile broadband
network. It's another way Sprint Business
helps you make just about any place a
workplace. And now, get a card for free.

**FREE
CARD**

with new card activation on unlimited
data access plan. Requires 2-yr
agreement and \$49.99 mail-in rebate.
No voice plan required.

1-8SPRINT-BIZ
sprint.com/mobilebroadband

Sprint  **POWER UP**
Together with NEXTEL

Sprint Mobile Broadband Network reaches over 174 million people. Coverage not available
everywhere—see map for details. Coverage comparison based on most recent available
information regarding Cingular broadband market coverage as of 11/27/06. Offer not
available in all markets/locations. Subject to credit approval. Additional restrictions apply.
Requires purchase by 2/17/07 and activation by 3/3/07 of a new line on Unlimited Data Plan
(\$59.99) and two-year agreement. \$36 activation fee and \$200 early termination fee apply.
Mail-in Rebate: Rebates cannot exceed purchase price. Taxes excluded. Line must be active
30 consecutive days. Allow 8–12 weeks for rebate. ©2006 Sprint Nextel. All rights reserved.
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FRAUD ALERT

DIAGNOSIS: IDENTITY THEFT

For \$60, a thief can buy
your health records—and
use them to get costly care.
Guess who gets the bill

BY DEAN FOUST

WHEN LIND WEAVER opened her mailbox one day in early 2004, she was surprised to find a bill from a local hospital for the amputation of her right foot. Surprised because the 57-year-old owner of a horse farm in Palm Coast, Fla., had never had worse than an ingrown toenail. After weeks of wrangling with the hospital's billing reps, Weaver finally stormed into the facility and kicked her heels up on the desk of the chief administrator. "Obviously, I have both of my feet," she told him.

Weaver eventually persuaded the hospital to drop the charges but in the process discovered that the mistake wasn't a simple billing error. Weaver's identity had been stolen by a fraudster who had used her personal information—her address, Social Security number, and even her insurance ID number—to have the expensive procedure performed. The nightmare didn't end there. When Weaver was hospitalized a year later for a hysterectomy, she realized the amputee's medical info was now mixed in with her own after a

nurse reviewed her chart and said, "I see you have diabetes." (She doesn't.) With medical data expected to begin flowing more freely among health-care providers, Weaver now frets that if she is ever rushed to a hospital, she could receive improper care—a transfusion with the wrong type of blood, for instance, or a medicine to which she's allergic. "I now live in fear that if something ever happened to me, I could get the wrong kind of medical treatment," she says.

Weaver's experience isn't an isolated case. Medical identity theft—in which fraudsters impersonate unsuspecting individuals to get costly care they couldn't otherwise afford—is growing. Based on Federal Trade Commission surveys, Pam Dixon, executive director of the World Privacy Forum, a San Diego-based research group, estimates that more than 250,000 Americans have had their medical information stolen and misused in recent years. And this isn't petty larceny. Experts note that while individuals who have had their credit-card data stolen are usually wrangling with their banks over losses of as little as a few thousand dollars, medical ID theft can leave vic-

tims, and the doctors and hospitals provided the care, staring at bills that exponentially higher.

Yet the thief isn't always an individual desperately needing medical care. In some instances, the perpetrator can be a doctor hoping to pad his or her income by filing fraudulent claims. Even worse, law enforcement authorities estimate that more and more frauds are being perpetrated by organized crime rings who steal dozens, and sometimes thousands, of medical records, as well as billing codes for doctors. The rings may set up fake medical clinics—offering health screenings as a ruse to draw in patients—that submit bogus bills to insurers, collect payments for a few months and then disappear before the insurers realize they've been had. (Dixon notes that health records now fetch \$50 to \$100 each on the black market, vs. a mere \$60 for stolen résumés.)

Last year, California authorities busted a ring in Milpitas that recruited patients from a local senior citizen center with offers of a free checkup and a case of free nutritional supplement. In the two months before authorities raided the cl



the ring had billed \$900,000 for diagnostic tests it had never performed. "Yesterday's drug dealers are now working in today's health-care fraud," says John Askins, an investigator in Florida's state insurance fraud division. "It's more lucrative, and they don't face the same dangers they do in the narcotics trade." The penalties, if they're caught, are lower, too.

Health-care providers say the Bush Administration's initiative to push doctors and hospitals to convert their paper-based patient files into digital records should help reduce the number of medical ID fraud. "Our software has become more sophisticated, particularly in identifying spikes in usage—someone who normally goes to the doctor once a year and suddenly goes 25 times in a 12-month period. It's a red flag," says Byron

patient data to fraudsters on the outside, privacy advocates believe that allowing data to flow more freely around a national network could make such thefts even easier. "We can expect [medical ID theft] to grow the more we move toward an electronic health-care system. It's going to be a disaster," says Dr. Deborah Peel, an Austin (Tex.) psychiatrist and founder of the Patient Privacy Rights Foundation.

Even worse, it can be difficult for patients to purge any fraud from their records. While the Fair Credit Reporting Act gives victims of financial identity theft the right to see and try to correct any mistakes

Victims can find their medical info mixed up with the fraudster's

Denver. The hospital was seeking \$41,188 for surgery that Ryan says he had never performed. Ryan called the hospital and, in time, realized that someone had stolen his personal information to pay for the surgery. Eventually, the investigator traced the crime to a former clerk at a newspaper, which Ryan had placed an ad for his sightseeing business.

"He asked for my Social Security number, and I now realize I should have given it to him," says Ryan.

When Ryan tried to correct his records, he discovered how difficult it can be for victims to clear their names. The hospital wouldn't let him see his own medical

records when they determined that the signature on the driver's license Ryan handed them didn't match the signature that the perpetrator had used when checked in. "They said it couldn't be Joe Ryan," he recalls. While the hospital eventually absorbed the loss, Ryan says he has been able to completely erase the supposedly unpaid debt from his credit record. With his credit ruined, Ryan says he had to pay a stiff interest rate—six points over prime rate—when he refinanced his plane, and his insurance company had jacked up his premium. "It has been like a glacier moving over me," he says. "I'm just screwed because I'm going to lose my plane, my business, and my credit rating."

In other instances, a thief can be a patient's

own doctor. Debra Herriott discovered that after she and her husband began seeing Boston psychiatrist, Richard P. Skodnek in the 1990s. After two years of therapy, Herriott began receiving statements from her insurer, Blue Cross & Blue Shield Assn. of Massachusetts, showing that Skodnek had billed Blue Cross for sessions the Herriotts had already covered. What's more, Herriott learned that Skodnek had also billed her son and daughter for psychiatric sessions that Debra says never occurred. "My children had never laid eyes on him," she says. Fortunately,

Medical ID Theft

How to Find Out Where You Stand

- Most patients toss out those "Explanation of Benefits" letters unopened. You should read them carefully to make sure no unauthorized treatment was performed in your name.

- Each year, ask your insurer for a "history of disclosures" from your doctor or insurer. This lists what medical information of yours was disclosed, as well as when, why, and to whom it was given, and can help spot fraud.

- Check your credit report periodically. Some victims learn of ID theft from collection notices for care they didn't get.



What to Do If You're A Victim

- File theft reports with both the police and your insurer.

- Contact the Federal Trade Commission, which provides helpful resources on resolving identity theft (877-438-4338 or consumer.gov/idtheft/).

- Request a copy of your medical records from your doctor or hospital. If they refuse, file a complaint with the Office of Civil Rights at Health & Human Services (800-368-1019 or hhs.gov/ocr/privacy/howtofile.htm).

Hollis, national anti-fraud director for the Blue Cross Blue Shield Assn., a trade group for 39 health plans.

But some privacy advocates fear that the rush toward digital health records could ironically create new nightmares for victims of medical ID theft. Rather than residing in a single doctor's paper files, fraudulent information—such as the erroneous diabetes diagnosis in Lind Weaver's records—could circulate in other medical databases across the country. Given that some medical ID thefts are "inside jobs," wherein rogue clerks sell

in their credit records, critics say that victims of medical ID theft don't have the same recourse. Health privacy laws "are limited and don't reflect the possibility of medical ID theft," notes Robert Gellman, a leading privacy consultant in Washington. "Negative information could just bounce around the system forever."

For some victims, the pain is real. Take the case of Joe Ryan. In early 2004, the 60-year-old owner of a Colorado sightseeing business (he flies passengers in a modern replica of a 1939 biplane) got a bill from a hospital outside

er Herritt, the feds were already on Kodnek's trail for defrauding other patients, and in 1996 the psychiatrist was convicted on 136 counts. Even then, Herritt says she spent the next couple of years trying to convince Blue Cross that her children had never been treated for depression. "It was an incredible invasion of their lives," Herritt says now. "I just pray this doesn't come back to haunt them somewhere down the road."

YOU'D BE ASTONISHED'

LAW ENFORCEMENT authorities complain that many health-care facilities do little to protect their patient data. Case in point: In September, federal authorities arrested a scheduling clerk at the Cleveland Clinic's Weston (Fla.) hospital who allegedly had passed on the personal identification information of more than 100 patients to her cousin—who in turn submitted \$2.8 million in false claims to Medicare. "Hospitals have done a poor job of implementing security procedures on their computer systems," says one federal investigator. "You'd be astonished how many people have access to your medical records." (Cleveland Clinic officials say they notified law enforcement officials when fraud was detected in June, and say they've since conducted an internal risk assessment to prevent such a problem in the future.)

In their defense, health-care executives say they've taken steps in recent years to deter identity thieves. Some hospitals, for instance, have begun reprogramming their computer systems to restrict staffers from accessing any patient data beyond what they need to do their jobs. And some have instituted procedures to ensure patients are who they claim to be.

Among them is the University of Connecticut Health Center in Farmington. After one patient impersonating a distant relative gained admittance and ran up more than \$76,000 in bills in his cousin's name, hospital administrators two years ago began requiring anyone seeking treatment to produce a picture ID. "We've since had instances where patients say, 'I left my ID in the car,' then leave and never return," says Marie Whalen, the center's assistant vice-president for ambulatory services. And beginning next March, Whalen says the center will begin scanning these picture IDs into their files to help staffers confirm each patient's identity on subsequent visits. "Most people are fine with that," she says. Indeed, it may be a small price to pay to avoid ID theft. ■

STARTUPS

THE RETURN OF THE TECH IPO

Silicon Valley pundits are predicting that 2007 will be the biggest year since 2000

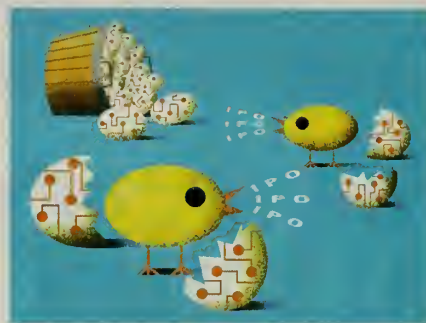
BY SPENCER E. ANTE

WHEN THE STOCK market reached the height of irrational exuberance in 2000, the bubble was filled largely with the hopes of technology startups going public. That year, 170 high-tech companies sold nearly \$19 billion of stock to investors in initial public offerings.

Since then, new tech-stock offerings have been mired in a six-year hangover as mergers and acquisitions became the exit strategy of choice. In 2006 only 35 tech companies sold stock to the public, about the same as 2005. Rather than taking years to build a solid business and cash out via IPO, the fantasy for many Silicon Valley entrepreneurs and financiers has been to get snapped up by Internet kingpin Google Inc.

Now it looks as if that could change. A steady rise in interest rates and inflation, a recent rally in the tech-heavy NASDAQ, and exceptional performance of tech offerings since the summer of 2006 have given observers hope of a significant rise in technology IPOs this year. They point to a rise in IPO filings, usually a reliable indicator of growing interest: In 2006, 67 technology companies filed notice that they plan to go public, a 31% increase over 2005, according to Boston boutique investment bank America's Growth Capital.

As a result, bankers and investors say somewhere between 60 to 75 technology startups could make their debut on U.S. public capital markets in 2007, including such anticipated offerings as wireless broadband provider Clearwire Corp. and



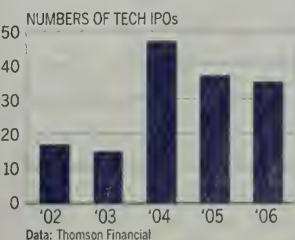
security software maker Sourcefire Inc. "[2007] will be the biggest year since 2000," predicts M. Benjamin Howe, chief executive of investment firm America's Growth Capital.

Another boost could come this spring when regulators are likely to ease some of the Sarbanes-Oxley Act rules that have scared many startups away from the public markets. Changes being considered by the Public Company Accounting Oversight Board, for instance, would remove audit requirements that are disproportionately costly for small companies. "For those companies that want to go public, it would make it easier," says Herbert S. Wander, a Chicago-based partner at law firm Katten Muchin Rosenman.

Optimists are hopeful that the improving climate will encourage a new class of quality startups to come off the sidelines. The CEOs of some of those companies will tell you that the classic Silicon Valley dream of building the next great tech

company is far from dead. "Entrepreneurs don't found a company to make Google better," says Zachary A. Nelson, CEO of software provider NetSuite Inc., which recently chose an investment bank for an expected 2007 IPO. "They found a company to make a mark on the industry." ■

READY FOR A REBOUND?





AEROSPACE

THE SECRET WEAPON AT BOEING

A booming business in cargo planes has lifted sales as competitor Airbus struggles

BY STANLEY HOLMES

WHILE BOEING and Airbus compete vigorously for passenger-jet sales, a confluence of luck (good for Boeing Co., bad for Airbus) and smart planning has left Boeing the virtual sole supplier of new air cargo jets. Delays and canceled orders have marred production of Airbus' A380 freighter, which had been meant to assault Boeing's 90% control of the air freight market.

In the aerospace industry, it's usually the airlines and aircraft leasing companies that dictate pricing. But now, as Airbus struggles, deals are being done on Boeing's terms. With newfound pricing power, Boeing will enjoy higher margins on its new freighter sales. That will mean robust results for Boeing commercial airplane sales and will help make 2007 a banner year for the Chicago-based aerospace giant.

Prosaic cargo planes may be overshadowed by such higher-profile projects as Boeing's glamorous 787 Dreamliner pas-

senger jet. But sales of cargo haulers are booming. Two months ago, industry bellwether FedEx canceled its A380 order to buy 15 new Boeing 777 freighters. New freighter sales are pushing Boeing's 2006 order book, which now stands at 904 planes, closer to 2005's record orders of 1,002 aircraft. For the first time new freighter jets make up 17% of Boeing's total aircraft sales, boosting the commercial airplane backlog to a record \$154 billion. Such sales usually make up 10% or less of plane sales. "I've never seen two years like this," says Larry D. Dickenson, a Boeing sales vice-president. "I don't think we'll ever see this again."

The rise of Asia, particularly China, as the world's primary manufacturing outpost is driving the demand for air freight. According to Air Cargo Management Group, air freight is projected to grow faster than passenger travel, by about 6.4% annually over the next 20 years, vs. 4.5% for passenger. Also, higher fuel prices

UP, UP, AND AWAY
Boeing's new 747-8 freighter plane will go farther without refueling

have created additional need for fuel-efficient twin-engine jets like the ones offered by Boeing

For Boeing, the delays on the Air A380 create a sort of virtuous cycle. First they force companies to switch freight orders, as big aircraft lessor International Lease Finance did, as well as FedEx. Second the delays in the passenger version of A380 mean potential customers have kept older planes, such as Boeing 747-400 in passenger service longer, rather than convert them into cargo haulers—a far cheaper option than buying new. Fewer used planes lying around means more demand for new cargo jets, and bigger sales for Boeing.

SMART STRATEGY

BOEING'S NEW 777 freighter will come out of the factory in the fourth quarter of 2008, to be followed by the new, enlarged 747-8 in 2009. Airbus says it's not canceling the A380 freighter, but experts wonder if it can afford the expensive program when it has only managed to sign up a single big buyer, United Parcel Service Inc. "It's hard to justify a program of that magnitude with basically one prime customer," says Richard L. Aboulafia, an aerospace analyst at aerospace consulting firm Teal Group.

Boeing's ability to meet demand stems from a strategy mapped out six years ago. It was partly a response to the A380, which can carry 141 metric tons, vs. 113 for Boeing's 747 freighter version. The A380 also could fly farther without refueling. So Boeing powwowed with cargo companies, tailored its fleet to their needs, and created a business converting passenger jets into freighters then began to develop planes that could fly farther without refueling and that had efficient engines.

A key goal was to keep operating costs lower than those of the 1,800 freighters in service. In May, 2006, Boeing unveiled the design for its twin-engine freighter, which has operating costs about half that of four-engine freighters. In November it launched the 747-8; its fuel-efficient engines match A380 on range and burn it on cost. With numbers like that, and with Airbus woes, odds are Boeing's order book will grow even thicker. ■

THE STAT

17%

Percentage of Boeing's total aircraft sales coming from freighter jets

BARNEY FRANK'S GRAND BARGAIN'

power in the new Congress is ready
to cut an enticing deal with business

Barney Frank, the liberal Massachusetts Democrat and incoming chairman of the House Financial Services Committee, offers this "grand bargain": If business supports parts of his agenda, such as empowering unions, he'll champion the corporate cause on immigration, foreign direct investment, and trade. Washington correspondent Lorine Woellert talked with Frank.

the grand bargain:

Many Americans believe growth hurts them. They're angry. So business can't get a trade bill through, it can't get rational immigration policy. There are real problems here economically and morally, and politically we've got to accompany new policies with rules. I'm for more immigration, but I want people to be able to join unions. That's the bargain. Demo-

crats can get things through the Congress, but we've got to get the President to sign them. It seems to be in our mutual interest to start working together.

On deregulation:

There are deregulatory things I want to do; I think in some cases we have hindered the market. Where there is consumer fraud I'm worried, and where poor people get screwed. But take hedge funds. If you've got \$10 million and you want to invest in a hedge fund, smoke three packs of cigarettes a day, and ride your motorcycle without a helmet, good luck to you. All my energy goes to try to protect people from other people. I have zero energy left to try to protect people from themselves.

On limiting executive pay:

Let the shareholders vote, and we won't take a substantive position [or hold hearings].

On the role of directors:

I think boards see themselves as legitimately adversarial toward the unions, but not toward the CEO.

On shareholder access to proxies:

Shareholder democracy solves a lot of problems. We're not talking about a lot of individual cranks. We're talking about some fairly responsible people with a lot at stake. They're not interested in damag-

ing a corporation. They're not interested in sacrificing profit for social causes.

On foreign investment in the U.S.:

We're ready to pass a bill [to set guidelines and more stringent requirements], but if the Senate can't pass it, we'll ask the President to sign an executive order [formalizing enhanced oversight].

On overseas outsourcing of jobs:

You can't stop it.

On how best to deal with China's undervalued currency:

We threaten economic retaliation. We greatly underestimate the attractive power of the American market. Why are the Chinese financing our deficit? Because they love us or because it's the best place to make money? I'd tell the Chinese we're going to put some restrictions on what they can sell here. If they couldn't sell in America, they would fall apart.

On health care:

We have this ass-backward view that if we spend money on Boeing, beer, NASCAR, and pornographic movies, that's good, it's adding to the GDP. But if I'm really sick and I want a private hospital room instead of being in a ward, that sends the GDP percentage of health care up and that's bad. My solution is Medicare for everybody, with increasing copays according to your income.

On homeownership:

We will raise the limit of the median house price that the Federal Housing Administration can insure. Then we'll take the money that generates to offset the higher loan-loss rate when we extend [guaranteed loans] to lower-income buyers.

On derivatives:

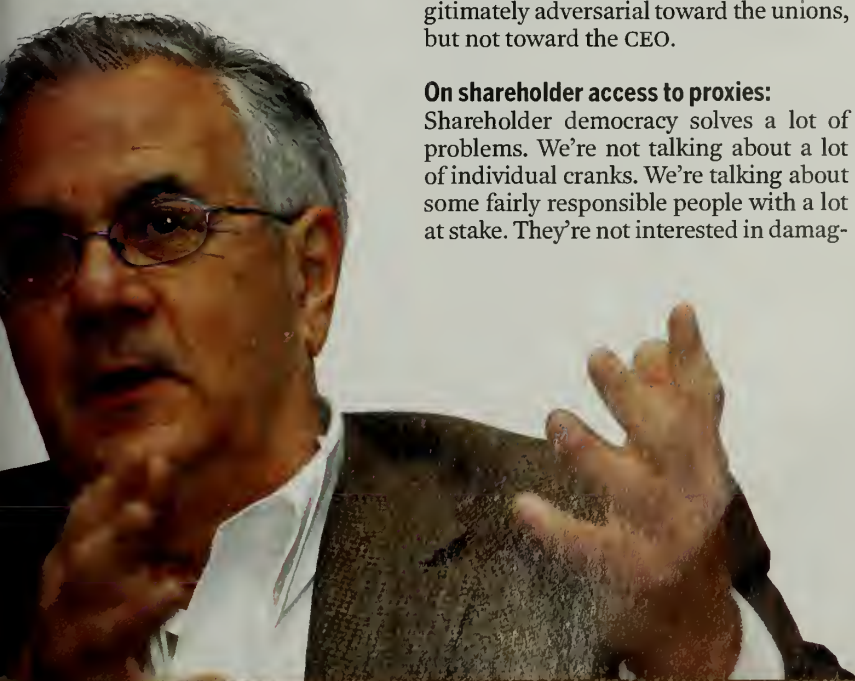
I'm convinced that accounting for derivatives ranges somewhere between astrology and alchemy. We worry about pension funds getting in over their heads with hedge funds. There could be regulation.

On trade:

I'm uncomfortable having to oppose policies that could be helpful to people in other countries. But I cannot support policies that put the entire burden of helping the poor overseas on middle- and working-class people here.

On Hank Paulson:

It turns out there's a lot to be said about having a person from Wall Street as Secretary of the Treasury. ■



DRUGS

A LITTLE BLUE PILL FOR WOMEN?

A German drugmaker has stumbled upon a substance that increases female arousal

BY JOHN CAREY

GERMAN DRUGMAKER Boehringer Ingelheim didn't set out to create a Viagra-like drug for women. The company was simply trying to develop a fast-acting antidepressant, one that patients would respond to in a matter of days, not weeks like most current treatments. By the late 1990s the company had developed a molecule called flibanserin that seemed to relieve stress in rats. But like many promising drugs, it flopped in human trials. Says Dr. Lutz Hilbrich, the company's executive director of general medicine: "We did not see the effect we were expecting."

But what they did see surprised them. Like all companies working on antidepressants, Boehringer surveyed patients in its clinical trial to assess dampening of libido, a well-established side effect. Far from complaining about a drop in sexual desire and arousal, many of the women in the trial reported a surge. The men had no such response—and neither group showed any improvement in mood. "It is an interesting drug," says Dr. André T. Guay, director of the Center for Sexual Function at the Lahey Clinic in Northshore, Peabody, Mass., and assistant professor at Harvard Medical School. "These things come about in strange ways."

It's hard to escape a comparison with Viagra. In the mid-1990s, researchers at Pfizer Inc. were testing an experimental drug for angina, or chest pain, and were stunned to discover the stimulating side effect. Since Viagra hit the market in 1998, drugmakers have been

The effect on the central nervous system is still being studied



searching for the female equivalent. Procter & Gamble, for instance, is trying to win Food & Drug Administration approval for a testosterone patch that produces modest effects in women, and others are testing topical creams and nasal sprays. "It is a very large potential market for drug companies," says Cleveland Clinic urologist Dr. Jeffrey

S. Palmer. Annual sales of erectile dysfunction drugs for men have already topped \$2 billion.

Boehringer has placed a big bet on flibanserin. The company has launched four major clinical trials, involving 5,000 women in 220 locations, with the goal

of applying for FDA approval in 2001.

Drug development is never easy, however, and flibanserin faces a tougher road than usual. There's an ongoing controversy about whether or not a male analog to erectile dysfunction exists. In October, the Endocrine Society issued guidelines cautioning that, if it exists at all, may be nothing to do with any "defect in woman's physical sexual response system." The Society concluded that the most common current treatment, testosterone, should not be recommended. The big question: If a woman doesn't experience physical desire, is it a medical condition, like inadequate blood flow in men, or something purely psychological? "Maybe she just doesn't like the sex she's with," says Washington, D.C., psychotherapist David Waldman.

NOT SO FAST

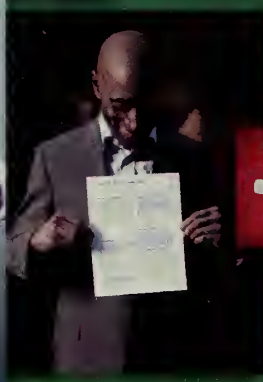
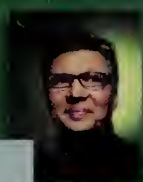
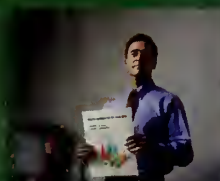
PLUS, IT'S NOT YET clear exactly how flibanserin works. Company researchers have figured out that it affects several circuits in the brain that are linked to feelings and pleasure. One of those circuits apparently helps control sexual desire and arousal, although the effects are not immediate. "This is not something that should be taken on a Friday for the weekend," says Boehringer Ingelheim spokesman Mark R. Vincent. "There is a gradual increase in sexual desire over a six- to eight-week period."

Pinning down the mechanism is especially critical, in this case, because the FDA views drugs that affect the complicated central nervous system with extra caution. Regulators are especially wary of drugs that might be used widely

as a lifestyle choice rather than just to treat a disease. "It is difficult for drugs for the central nervous system to be approved for something as banal as sexual dysfunction," says Lahey Clinic's Guay.

Doctors investigating new treatments for women retort that men's problems were also seen as largely psychological until Viagra came along, and that lack of sexual desire isn't trivial to many of those who experience it. Indeed, Boehringer says it's having no trouble recruiting women for the trial, some of whom travel long distances for a chance to try the drug. Even if flibanserin doesn't pan out, understanding how it boosts desire should point the way to better versions—and perhaps give women a choice about whether or to pop a little pill. ■

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invent

STAGE PRESENCE

MUSIC TO THE STREET'S EARS

Live Nation has lots of fans, but those old acts can't rock forever

BY TOM LOWRY

MICK JAGGER SANG an electrifying encore of *(I Can't Get No) Satisfaction* on Nov. 25, as The Rolling Stones wound down their A Bigger Bang World Tour in Vancouver, B.C. Plenty of people got satisfaction, though. None more so than the members of the band—and investors smart enough to snap up shares in music promotion company Live Nation Inc. It stands to pick up a nice chunk of change from the Stones tour, which grossed a record \$437 million.

Thirteen months ago Live Nation belonged to radio behemoth Clear Channel Communications Inc. Back then it was the awkward stepchild Wall Street wanted booted from the nest. Shareholders felt the business, with its smaller margins, held back Clear Channel. As it turns out, the opposite may have been true: Live Nation shares have more than doubled, to about 22, since it went public in December, 2005. (Clear Channel, which still holds a 6% stake in Live Nation, is taking itself private.)

By some estimates, the spin-off could post an operating profit for 2006 of \$188 million on \$3.5 billion in revenues, mostly from ticket sales. Still, the Beverly Hills (Calif.) company's continued fortunes will depend at least partly on two things: the continued willingness of fans to pay \$100-plus to see a top act and the ability of these aging arena jockeys—the Stones, Eagles, Madonna, U2—to keep rockin' and rollin' with their bum knees,

high cholesterol, and domestic obligations. There aren't many bands these days with the power to pack in 3.5 million people over 15 months, as the Stones just did.

Ticket prices have been rising at an annual rate of 7% over the past five years. Great news for the Gods of Rock, who, like most bands, make more money touring than selling CDs or singles. But ticket sales have fallen 3% annually over the past five years, and it doesn't take a scalper to know that you can raise prices only so far before fans start staying home and watching concert footage on YouTube.

So far revenues from tickets and merchandise have more than offset the drop in attendance. And, hey, Jagger may be 63, but a review of the 10 highest-grossing tours of the past six years shows the average age of each band's lead singer is about 48, according to Credit Suisse Group. "Although that could be considered high," writes analyst William B. Drewry, "we believe there is enough youth on the list to keep generating ticket sales over at least the next three to five years."

Still, Live Nation, which operates 172 venues around the world, isn't waiting around for big acts to become too creaky to tour. It is looking to bolster its business with smaller shows put on by younger bands. In 2006 it acquired rival House of Blues Entertainment, whose



SATISFIED Jagger and the Stones grossed \$437 million on their latest tour

theaters and clubs seat fewer than 2,000. Thanks to a surge in small shows, the number of U.S. concerts held each year rose from 5,000 in 2000 to 14,000 in 2006, according to Goldman, Sachs & Co. That's largely why Live Nation is focusing on music, shedding divisions promoting sports events, Las Vegas productions, and speaking tours. "At the end of the day," says CMO Michael Rapino, "we want to go much deeper into music at the local level."

At the same time, Live Nation is looking at selling underperforming arenas, focusing instead on the halls in the 120 U.S. cities. Investors are also hopeful the company, the biggest of its kind, can use its leverage to negotiate better revenue-sharing deals with Ticketmaster and food and beer vendor Aramark Co. when contracts come up for renewal. Live Nation is also pushing beyond the U.S. In December it snapped up the largest concert promoter in Spain, and it's buying a stake in another promoter in France.

Ticket inflation has been driving a big part of fans could squeeze revenues and margins. Following such a robust 2005, the last thing Live Nation wants now for Wall Street to pocket its Bic lighters and head for the exits. Rapino professes himself unfazed. "Music has been commoditized to a certain degree," he says. "But that fourth seat in the seventh row is unique." Even if the geezer on stage old enough to be your grandfather. ■

THE STAT

109%

Gain in Live Nation's stock price since going public on Dec. 14, 2005

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EMERGING MARKETS

PRIVATE EQUITY INVADES INDIA

Strong growth and a hot market have foreign investors pouring in billions

BY NANDINI LAKSHMAN

RAJEEV GUPTA IS USED to living out of a suitcase. The 47-year-old managing director at Carlyle Group in Mumbai spends much of his time crisscrossing India in search of diamonds in the rough—medium-to-large family-owned companies in need of outside capital and management know-how. “India’s attractiveness to private-equity investors is not merely its sizzling economy,” says Gupta, who runs the numbers on about a half-dozen deals a month. “Indian companies also have the highest return on equity in Asia.” How high? The former banker says it’s about 21%, compared with 9% for China, numbers that have spurred Washington-based Carlyle to invest \$50 million in Indian businesses ranging from pharmaceuticals to tech consulting.

Carlyle is in good company. India’s combination of 8%-plus growth and a

roaring stock market is drawing throngs of U.S. and European venture capitalists and private-equity funds. In the past month alone, more than 100 foreign outfits have met with KPMG’s newly created private-equity group in Mumbai, says the unit’s chief, Vikram Utamsingh. “All kinds of global funds have India on their radar,” he says.

The directories of swank office towers in Mumbai, Bangalore, and Delhi read like a who’s who of the business: Besides Carlyle, there’s Kohlberg Kravis Roberts, Blackstone Group, Warburg Pincus, Texas Pacific, and dozens of others. “It seems like the gold rush is on,” says Abhay Havaladar, a managing director at Greenwich (Conn.)-based General Atlantic Partners. In the past four years, his fund has sunk \$550 million into seven Indian companies in sectors such as television broadcasting and back-office outsourcing.

The pace of dealmaking is furious. In the first nine months of 2006, India saw 329 venture capital and private-equity



investments worth a total of \$5.9 billion more than double the tally for 2005—w some 60% coming from foreign players according to researcher Venture Intelligence India. The size of deals is growing too: from around \$8 million four years ago to an average of \$25 million today. The record for 2006 was set by Idea Cellular, which in November received \$9 million from a clutch of investors including Providence Equity Partners, Chr Capital, Citigroup, and Spinnaker Capital. A new benchmark may be just ahead: Reliance Communications is in talks with private-equity players such as Blackstone, Texas Pacific, and KKR to fund what could be a \$10 billion-plus bid for cellular carrier Hutchison Essar.

It was telecommunications that really ignited interest in India. In 1999, New York-based Warburg Pincus made a \$300 million bet on regional carrier Bharti Airtel, which has since grown into the country’s biggest cellular company. Over the past few years, Warburg I

Follow the Money

Top private-equity investments in India in 2006

COMPANY	SECTOR	AMOUNT (millions)	INVESTORS
IDEA CELLULAR	Telecom	\$950	PROVIDENCE, CITIGROUP
FLEXTRONICS SOFTWARE	Info tech	765	KKR, SEQUOIA CAPITAL
INDIABULLS	Finance	143	FARALLON CAPITAL
L&T-IDPL	Construction	124	JPMORGAN CHASE, IDFC
QUATRRO	Business services	100	OLYMPUS CAPITAL

Data: Venture Intelligence India



BANGALORE
Coffee Day has
tapped Sequoia
for cash to expand

and the stake for a total of \$1.6 billion, it hasn't lost its appetite for India. Warburg has pumped \$1.4 billion into companies from hotels and media to jewelry, and India today represents 10% of its global portfolio.

In India, as in other fast-growing emerging markets, the distinctions between private equity, venture capital, and other forms of financing are often blurry. A company resists selling majority control outright, private-equity outfits such as Warburg and Carlyle will often purchase a minority stake, usually between 5% and 30%. Meanwhile, investors such as Sequoia and Citigroup Venture Capital, which typically finance startups, are pouring money into more established companies.

One of those is Coffee Day. The decade-old chain expects about \$100 million in revenues for 2006 and has nearly 1,000 outlets across India, a mix of cafés, highway convenience shops, and retail coffee stores. In July, Sequoia—a Sili-

con Valley venture fund with \$750 million invested in India—poured \$20 million into Coffee Day's parent company, a coffee grower and trader with ambitious plans. It hopes to have 2,500 outlets in India by the end of 2007, and expects to boost its presence in Europe, where it has already opened two shops in the heart of café culture, Vienna. "With enough private equity, we are able to pursue our expansion plans aggressively," says Naresh Malhotra, a former head of KPMG India and now managing director at Coffee Day.

With so much money flooding in, some fear a bubble. "The market is overheated," says Carlyle's Gupta. Valuations are spiking ever higher as Indian firms play one suitor against another and potential investors elbow each other out of the way. For instance, Hiranandani Developers, a builder of gated communities and

The rush of money has raised fears of a bubble

high-end office towers, has gotten offers of as much as \$100 million from more than a dozen outfits. "It's crazy the way people are throwing money at deals," says founder Surendra Hiranandani.

One reason investors continue to throw money into India is that it offers a good way to cash out with a profit: its comparatively liquid and transparent stock market. The Bombay Stock Exchange's benchmark Sensex index is up 42% since January, spurred in part by IPOs for 15 private-equity-backed companies that raised a total of \$887 million.

Another selling point is an abundance of family-owned companies. Although Indian clans have traditionally been reluctant to give up management control, the younger generation is often prepared to trade away a chunk of equity in exchange for cash and some advice on beefing up sales.

BEYOND TELECOM

THAT'S HOW DRUG researcher Glenn Saldanha hooked up with British investors. Saldanha, who had worked for Eli Lilly & Co. in the U.S., returned to India in 1998 to help run his family's company, a Mumbai-based generics maker called Glenmark Pharmaceuticals Ltd. With an eye toward expanding overseas and boosting research, he took Glenmark public, floating 30% of the company. Then in 2002 Saldanha accepted a \$10.2 million offer from London-based Actis Partners for a 15.4% stake. Under Actis' guidance, Glenmark streamlined its financial systems and launched a search for strategic partners. Revenues for the fiscal year ended in March were up 14% from 2005, to \$126 million, while profits climbed more than 6%, to \$1.5 million. "The funding put pressure on our management team, which drove us toward this fast and aggressive growth," says Saldanha.

As India's economy continues to open up, private-equity investors are starting to diversify away from telecommunications and outsourcing. These days, health care, food, real estate, travel, and more are heating up. In addition to Coffee Day, for instance, Sequoia has plowed money into a rental-car company, a hotel chain, and a Web portal that helps arrange marriages. Says Sequoia India boss Sumir Chadha: "Investors are focusing on building companies [that have] Indian demand." ■

JAPAN

THE GOLDEN OLDIE OF GAMING

Sony's PS2 is likely to outsell newer consoles such as the PS3—not just this year but next

BY KENJI HALL

IN DECEMBER VIDEO GAME MAKER Square Enix Co. began running prime-time TV ads in Japan featuring battle scenes from its new adventure game *Seiken Densetsu 4*, or *Legend of the Sacred Sword*. Every 30-second spot ended with a familiar logo: PlayStation. But the game isn't played on Sony Corp.'s new PlayStation 3 console. It's for the PlayStation 2.

This might seem an odd time to launch an ad blitz for a game designed for the PS2, which has been around since 2000. The PS3, after all, was just introduced this fall and offers richer graphics with more lifelike action. But despite all the hype surrounding the PS3, its predecessor is likely to outsell it for two more years. "The PS2 will have legs well into 2008," says Michael Pachter, an analyst at Wedbush Morgan Securities in Los Angeles. And while Nintendo Co.'s Wii console is getting most of the industry buzz, and the Xbox 360 from Microsoft Corp. has racked up big sales in its year on the market, some say the PS2 might even beat out each of those offerings in 2007. "The PS2 probably has the capacity to sell more than any other gaming" console, says Simon Jeffrey, chief operating officer at game maker Sega of America.

The PS2 already owns the industry's all-time sales record. As of last March, Sony had shipped more than 103 million units worldwide. In the year ending in March, 2007, Sony expects to sell an additional 11 million—and just 6 million PS3s. In the following year, Sony will likely ship another 11 million PS2s vs. 7 million PS3s, according to research by rating agency Standard & Poor's.

The PS2's direct rivals, Microsoft's original Xbox and Nintendo's GameCube, are no longer in production. So why is the PS2

doing so well this late in life? For starters, it's cheap. Sony has cut the PS2's price to about \$130, down from a high of \$300, to entice casual gamers and kids. And with continuing sales and so many PS2 consoles in living rooms worldwide, there's

RED ZONE

The much hyped PS3 will lose money for years



plenty of demand for new titles. "All media focus is on next-gen consoles: games, but a lot of the software companies will make a substantial portion their earnings by selling [older] games," says Erik Whiteford, marketing director at California game maker 2K Sports.

FAMILY FARE

TO KEEP SALES GROWING, software makers are tweaking their PS2 efforts. In the console's early days, hardcore gamers were its main audience, but the diehards are now moving on to the PS3. So makers are beefing up offerings with family-oriented titles, kids' games, and movie tie-ins. Square Enix next spring plans to sell *Kingdom Hearts II: Final Mix Plus*, a collaboration with Walt Disney Co. Around the same time, Paris-based Ubisoft will unveil *Teenage Mutant Ninja Turtles* to coincide with the release of a film in that series. And Sega is working on a game based on a film from Philip Pullman's story *The Golden Compass*, before the holidays in late 2007. While some of these will be available for other platforms as well, game makers have plans to discontinue PS2 titles.

Nor is Sony in any hurry to kill the PS2. The launch of a new console always puts game makers in the red, and the PS3 is no exception. With development and production snafus for the machine,

Sony's game unit is expecting a \$1.7 billion loss this fiscal year. The PS2, meanwhile, last August turned profitable as component prices have plunged and development costs have been written off. Even at \$130 a pop, Sony earns about \$8 on each PS2 it sells, compared with an estimated loss of \$250 per PS3. Nintendo is believed to break even on the Wii, while Microsoft takes a loss on the Xbox 360. And Sony will rake in some \$1.4 billion a year from license fees paid by game makers and sales of its console game titles for the PS2 and its predecessor, the PSOne, Goldman Sachs & Co. estimates. So it's clear Sony wants to milk the PS2 for all it's worth. ■



FLAT PANELS IN PLZEN

Tatung churns out 50,000 TV sets per month in the Czech city

OFFSHORING

MADE IN CHINA— ER, VELIKO TURNOVO

Mainland manufacturers are spending millions on Central European plants

BY DAVID ROCKS

THE GRAIN FIELDS around the Czech town of Nymburk are fallow at this time of year. But by next summer a new kind of harvest will be added to the wheat and barley. Chinese electronics manufacturer Sichuan Changhong is building a \$30 million factory in Nymburk that will turn out 1 million flat-screen televisions a year when it swings into full production. Getting Changhong into Nymburk is a big success for us," says Ladislav Kutik, mayor of the town of 15,000 an hour east of Prague.

Kutik and his fellow Czechs are experiencing one of the stranger paradoxes of globalization. China's rise has created plenty of headaches for Central Europe: Competition from the mainland has devastated the region's low tech, low-margin industries such as textiles and shoemaking. But like Changhong, growing numbers of companies are starting to manufacture in Central Europe as an alternative to production in China. While Japanese electronics manufacturers have been making their goods in the region for a decade or more, their counterparts based in China and Taiwan now are opening new plants and expanding

older ones there to get closer to Europe's wealthy consumers.

Dozens of Chinese and Taiwanese companies have plowed a total of at least \$300 million into the region. In the Czech Republic, Taiwan's Foxconn Technology Co. manufactures PCs and other gadgets for the likes of Hewlett-Packard, Cisco Systems, and Apple Computer at an \$80 million plant employing 5,000 people in the city of Pardubice, 60 miles east of Prague. Taiwanese TV manufacturer Tatung Co. has a factory in the western Czech city of Plzen that churns out 50,000 flat-screen sets monthly. Mainland consumer electronics maker Hisense Co. in November opened a TV plant employing 110 people in the Hungarian city of Szombathely, on the Austrian border. And in October, Shanghai-based SVA Group inaugurated a factory making TVs and other electronic products in the central Bulgarian city of Veliko Turnovo.

The attraction is simple: Central Europe provides a back door to the European Union. Since the EU expanded into the former Soviet bloc countries in 2004 (Bulgaria and Romania are sched-

uled to join on Jan. 1, 2007), the region has offered a manufacturing base where wages are still a fraction of those in Western Europe. Governments in the new member states are eager to attract investment, often offering rich incentives to manufacturers that will create jobs. Foxconn and Changhong, for instance, have been granted 10-year tax holidays in the Czech Republic. And producing in the EU lets companies avoid the 14% tariff Brussels slaps on televisions made in China. "To enter the European market, we have to be here," says Wang Wensheng, general manager of Changhong's Czech subsidiary.

SPEED COUNTS

MANUFACTURING IN THE region can make sense even for goods that don't face tariffs. Operating in Central Europe lets companies quickly boost output to meet spikes in demand and get products to users far faster than shipping them by boat or even air from China. Foxconn makes millions of computers for HP at its sprawling 200,000-worker facility in south China. But if HP needs fast turnaround on PCs for Barcelona or Berlin, workers in the Pardubice factory can put them on a truck in as little as 24 hours. "When customers want things basically yesterday, you can't afford to have them sitting on a ship for 35 days," says Jim B. Chang, chief of Foxconn's operations in the region.

That's not to say it's cheaper to operate in Central Europe than in China. Far from it. Labor rates in the Czech Republic are roughly \$500 per month for a 40-hour week. That compares with about \$100 to \$150 monthly in China for much longer hours. And while productivity in Czech plants is roughly equal to that in Chinese factories, absenteeism hits 15% some days. Those issues, plus surging currencies and growing labor costs, have prompted some companies to look at Ukraine and Russia. "Our presence in the Czech Republic won't shrink," Chang says. "But if we need to expand much more, we'll go farther into Eastern Europe." ■

—With Katerina Zachovalova in Prague and Nichola Saminather in New York

**A presence
in Central
Europe offers
access to
EU markets
—without
tariffs**

How Business **Trounced** The Trial Lawyers

By focusing on litigation reform at the state level, business has won key battles. Suddenly, it's a tough time to be a plaintiffs' attorney

BY MICHAEL OREY



IN 1901 A WELL AT SPINDLETOP HILL SENT PETROLEUM SHOOTING 200 feet in the air and made Beaumont, Tex., one of the first oil boomtowns. Decades later some locals tapped into a different kind of gusher: personal-injury litigation. Starting with highway and refinery accidents, and then moving to asbestos and tobacco, lawyers at the firm of Provost & Umphrey hauled in the kinds of fees that would make Wall Street lawyers drool.

But as is the case with oil in Texas, the easy money in injury lawsuits is gone. Thomas Walter Umphrey says the firm he co-founded in 1969 is downsizing. It's also prospecting in other fields of law to try to keep the business flowing. A couple of hundred miles to the north, in Daingerfield, plaintiffs' firm Nix Patterson & Roach is also pushing in new directions. "If today we were relying on personal-injury cases in Texas, we would be bankrupt," says partner Nelson J. Roach.

What has happened in Texas is not unique. In state after state, the tide has turned in one of the most protracted, hard-fought political struggles of the past two decades—the battle over so-called tort reform. Few other business issues have generated more controversy, polemics, and campaign spending than the effort to scale back the types of lawsuits people can file and how

WILLIAM DUKE



much they can recover. In a speech on Nov. 20, for example, Treasury Secretary Henry M. Paulson Jr. charged that “the broken tort system is an Achilles’ heel for our economy” and exhorted his audience to tackle “one challenge that will take a concerted effort over the long term to correct—the need for reform of our legal system.”

But what Paulson and others have overlooked is that in large areas of the country, that “reform” has taken place, and business has emerged triumphant. *The American Lawyer*, an influential trade publication, recently declared an end to the era of mass-injury class actions, but the changes are far broader than that. Courthouse doors have slammed shut on a wide variety of claims. Michigan, for example, has virtually wiped out all lawsuits against drugmakers in the state. Six states have passed laws seriously restricting the kinds of asbestos suits that can be filed, and 23 now have statutes saying you can’t sue the likes of McDonald’s for making you fat. Damage limits in many states have rendered medical malpractice litigation nearly comatose.

Both federal and state courts are reinforcing the trend. In December a U.S. appeals court in New York nixed a class action accusing investment firms of manipulating the price of initial public offerings. That was a big loss for securities fraud plaintiffs’ lawyers, especially in a year when the total number of shareholder suits filed was about half the level of prior years, according to statistics compiled by Stanford Law School. In 2005 the Illinois Supreme Court struck down a \$10.1 billion judgment against Philip Morris, saying a state law protects the company from suits alleging that its marketing of “light” cigarettes was deceptive.

It all adds up to an extraordinary turnabout for the plaintiffs’ bar, which has reveled in public-savior images of its top guns hauling Ford and Firestone into court for disintegrating tires; standing side by side with state attorneys general to extract \$300 billion from cigarette makers; and trotting up courthouse steps with smoking-gun Enron documents. These days the law firm that once was the nation’s most prolific filer of shareholder lawsuits is under indictment, thousands of asbestos and silicosis claims are being probed for fraud, and Vioxx litigation, once thought to be a gravy train express,

In 2004,
business
groups put
\$21.5 million
toward state
supreme
court election
campaigns,
outspending
trial lawyers
for the first
time

is chugging in reverse. (Of 12 cases tried verdict involving the painkiller, Merck & Co. has won 8.)

Even many victories are evanescent. According to a report issued by Beasley, All Crow, Methvin, Portis & Miles, an Alabama personal-injury firm, the Alabama Supreme Court reversed 27 of 31 plaintiffs’ verdicts during its 2004-05 session. Thomas J. Methvin of the firm asserts: “It’s a tough time to be a plaintiffs’ lawyer, and it’s a tough time for consumers.”

Of course, when plaintiffs’ attorneys face a falloff in business, lawyers opposing them do, too, and in Texas both sides are feeling the pain. Surprisingly, even businesses not occasionally feel the sting of lawsuit reform. Plaintiffs’ lawyers, closed out of their traditional pursuits, are working harder to drum up claims companies can bring against consumers. Additionally, the conservative legal

climate may be making it harder for companies that believe they have legitimate claims to get what they feel they’re entitled to when they file a lawsuit.

Creative Litigation

IN LATE NOVEMBER about 300 attorneys descended on the W Dallas-Victory hotel for the annual conference of the Texas Trial Lawyers Assn. But rather than plotting the next industrial threatening mega-litigation, their goals were decidedly more modest. Attendees could sign up for a full-day “car wrecks seminar.” One presentation explored whether an automobile manufacturer’s failure to include electronic stability control on a crashed vehicle could be the basis for a negligence claim. Another offered tips on creating “trial exhibits on a budget.”

Coming up with creative new lines of litigation—and doing so on the cheap—is imperative for plaintiffs’ lawyers in Texas these days. No other state’s trial bar has suffered a greater reversal of fortune. Until well into the 1990s, Lone Star State plaintiffs’ lawyers walked tall. They pioneered asbestos litigation in the U.S., racked up eye-popping verdicts in cases involving everything from business fraud to diet drugs, and perfected the art of “rum shopping.” Companies dreaded getting sued in places like Eagle Pass, in the Rio Grande Valley, which has bucked the trend in Texas and remains a “hellhole” for business defendants, according to the American Tort Reform Assn.

Money poured in. Five firms, Umphrey’s among them, shared \$3.3 billion for representing Texas in its suit against

Taking It to the States

The business community has not had much success winning lawsuit reform in Washington, D.C. But it has been a different story in places like Colorado, Mississippi, and Texas.

CLASS-ACTION RESTRICTIONS

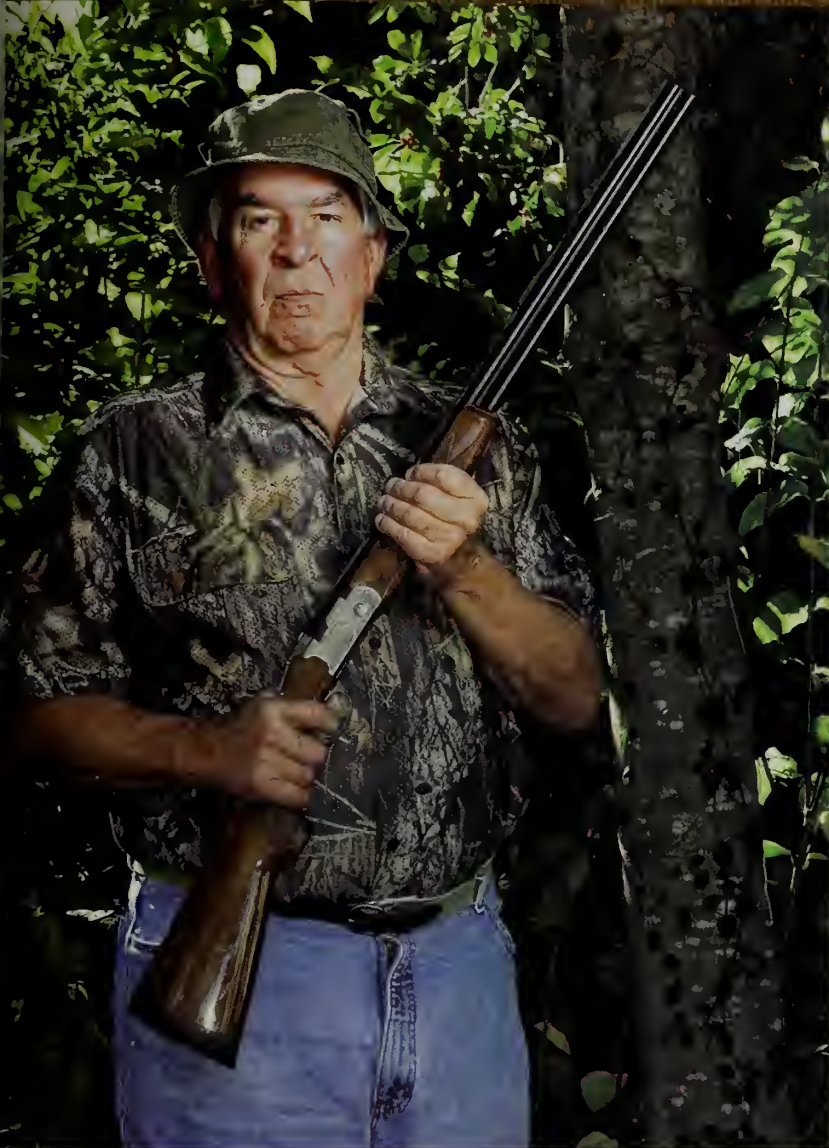


Legislatures in 9 states have made it harder to combine large numbers of claimants in a single lawsuit.

MEDICAL-MALPRACTICE MAXIMUMS



Limits on damages, including “punitive” suffering, have been approved in 23 states.



NEW QUARRY Lawsuit reform has forced Umphrey's firm to seek out business beyond personal injury cases

their opponents pursued very different strategies. While trial lawyers poured considerable resources into

electing plaintiff-friendly state judges and legislators, business groups aimed to win federal liability limitations in Washington, but repeatedly saw their efforts founder. One player who realized that a different approach was needed: Karl Rove. Not only did the current White House deputy chief of staff help elect George W. Bush as governor of Texas in the 1990s, but he also was instrumental in judicial-election campaigns that, by 1998, had converted the makeup of the Texas Supreme Court from 100% Democratic to 100% Republican. He played a similar role in flipping Alabama's high court. Particularly during the Bush presidency, tort reform has become a major talking point for Republican candidates at both the state and federal levels.

For years, says Stephen B. Hantler, an assistant general counsel at DaimlerChrysler Corp. and chairman of the American Justice Partnership, a recently formed litigation reform organization, "the business community stood on the sidelines and watched," reluctant to get involved in state politics. But by the mid-'90s, national groups like the U.S. Chamber of Commerce and the American Tort Reform Assn. realized, as Hantler puts it, "that the greatest return on investment is at the state level."

The trial lawyers and the business community entered a campaign-spending

arms race, but even for the well-heeled trial bar, it was no contest. In 2004, for example, business groups spent \$21.5 million on state supreme court elections, eclipsing the amount spent by plaintiffs' attorneys and their allies (\$13.3 million) for the first time, according to Justice at Stake Campaign, a Washington group that monitors judicial independence. Much of the money, from both sides, was channeled through state-level organizations that played a critical role in reshaping the legal landscape. The most powerful force for change in Texas has been the home-grown Texans for Lawsuit Reform. Since 1996, TLR's political action committee has spent more than \$13 million promoting liability limits, according

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PUNITIVE-DAMAGES LIMITS



Ceilings on the amount of punitive damages have been passed in 32 states.

BARRING OUT-OF-STATE PLAINTIFFS



Eight states once meccas for out-of-state plaintiffs now curtail suits by people with no connection to the jurisdiction.

APPEAL-BOND REFORM



Nearly three dozen states have limited the size of the bond needed to appeal a verdict—removing a huge burden for companies.

to Texans for Public Justice, a not-for-profit organization that tracks campaign spending and opposes litigation curbs. Big donors to TLR's PAC in 2006 included Bob Perry, a Houston homebuilder and funder of the Swift Boat group that attacked John Kerry (\$601,000); financier and oilman T. Boone Pickens (\$500,000); and real estate magnates Harlan and Trammell Crow (\$220,000 together).

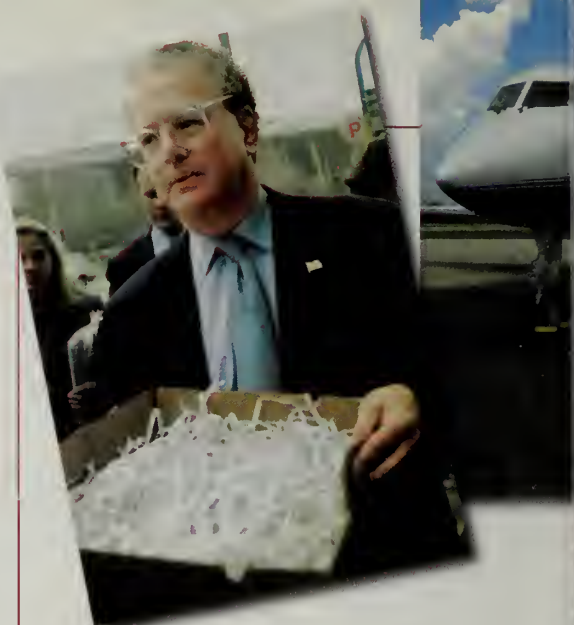
Sipping wine in his Houston home one afternoon in November, Hugh Rice Kelly, former general counsel of Reliant Energy Inc. and a leader of TLR, ticks off the changes his group has helped usher in. "We have covered most of the things we wanted to have corrected," he says, looking more than satisfied.

The changes came not all at once but in waves, starting in 1995 and crescendoing in 2003 with a far-ranging set of liability limitations. Collectively, they have eliminated just about all of the litigation concerns in Texas that keep company executives awake at night. Punitive damages now have ceilings that, for example, will reduce an August, 2005, award of \$253 million against Merck & Co. in a Vioxx case to \$26 million—if the verdict survives an appeal. Plenty of other states have cracked down in this area, as well. Georgia, for instance, limits punitive damages to \$250,000, unless "the defendant acted with a specific intent to harm," and New Hampshire bars them altogether. As for class actions in Texas, a series of judicial rulings has set the bar so high for a judge to approve them that it's effectively impossible to meet, practitioners say.

The far-ranging changes passed by Texas lawmakers in 2003 included one that bars injury suits against a seller more than 15 years after a product is sold. One result: After a doctor was decapitated by a Houston hospital elevator in August, 2003, no suit could be filed against the manufacturer, since the elevator was too old. Dallas attorney Todd Tracy notes that many other products, including automobiles, farm and construction equipment, and

Highlights From The Heyday

Viewed variously as crusaders for the common man or corporate shakedown artists, plaintiffs' lawyers have long been among the most flamboyant and high-profile players in the American business landscape. While their fortunes are now turning, the last decade saw them at the peak of their prominence. Remember these faces from the glory days?



ENRON EXCAVATOR

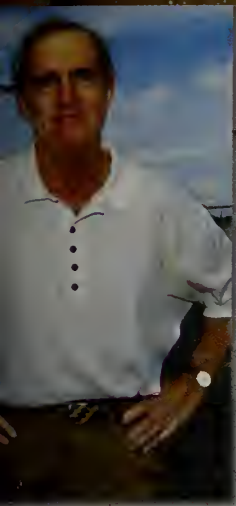
Shredded documents were an early sign that Enron had a lot to hide. In litigation against the energy giant's bankers, William Lerach has helped recover billions for Enron's shareholders, though still just pennies on the dollar.

factory machinery are used for extended periods and now enjoy the same protection. The rule is "one of the worst things about tort reform," says Tracy, who has his own firm, Tracy Car Boy ("'cause that's what I do. I'm a boy, and I sue car manufacturers").

Death Knell

DOCTORS ALSO GAINED substantial shielding under the 2003 statute, with a \$250,000 maximum on "noneconomic damages"—essentially pain and suffering. Both defense and plaintiff firms say this has been a death knell for many medical malpractice suits. The reason is that a huge number of potential claimants, such as kids and the elderly, suffer no lost income in the view of courts. That means the top recovery is \$250,000 and it can easily cost \$100,000 or more in expert fees to prepare a case for trial—making litigation a money-losing proposition for attorneys, who now turn these cases away in droves. "They've just taken away so many of the rights of victims here," says Carolyn St. Clair, a nurse and medical malpractice





« TOBACCO WARRIOR

Richard Scruggs crisscrossed the country in his private jet to help spearhead litigation against cigarette makers in the 1990s. Total take for his tiny Pascagoula (Miss.) firm: around \$1 billion.

BESTOS HEMIST

...sents thousands of
...rs exposed to the
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...orney in Houston.
...Consumer ad-
...vocate worry that
...as lawmakers

...ll move next to limit pain-and-
...ffering awards in product liability cases, too.
...n a national level, Hantler of the American Justice Partner-
...ip says he's not nearly done. He worries that lawsuits are
...migrating to states like West Virginia and New Mexico, after
...ackdowns elsewhere. And while he acknowledges that the
...sults of the November elections will have business playing
...ense for the next couple of years, he's already girding for
...ttle in judicial elections in Wisconsin and Ohio in 2008.
...The decade-long spending assault by TLR, the U.S. Chamber,
...d others has done more than just win judicial elections and
...ange laws. Lawyers in Texas say that after years of exposure
...TV commercials, billboards, and campaign speeches, public
...inion in the state has been profoundly affected. "They have
...monized trial lawyers as money-hungry thugs," complains
...ouston litigator David Berg. "They have brainwashed jurors."



» TIRE TRACKER

From his office in Corpus Christi, Tex., Mikal Watts made a name for himself pursuing suits for accidents allegedly caused by faulty Firestone tires.

The result, say Berg and others, is that they are often hesitant to bring cases before a jury. And when they do, the obstacles become quickly apparent. St. Clair says that during jury selection for a negligence trial she handled, dozens of prospective jurors had to be dismissed because they stated that they would not be able to award punitive damages or damages of more than \$1 million. "Everybody was raising their hands" to say they couldn't, St. Clair says.

While big jury verdicts are increasingly rare in Texas, they still occur. Thus the giant Vioxx award in 2005 and a \$36 million verdict in a highway crash case handed down in November. But such awards are vulnerable on appeal. According to Texas Watch, an Austin consumer advocacy group, of the 69 consumer cases accepted for appeal by the Texas Supreme Court during its 2005-06 term, it decided against the consumer in 57, or 83%, a trend Texas Watch says has been consistent for the past six years. "When you have a large verdict that you receive from a jury, you can't settle the case anymore because the defendants will walk in and say: 'We know we're going

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TOO MUCH REFORM?

Reed and Gray say the new climate may limit claims in business disputes

to win in the Supreme Court," says Frederick M. Baron, a Dallas attorney who has handled cases involving exposure to asbestos and industrial toxins.

In fact, lawyers on both sides have had to adjust. When the first round of liability limits passed in Texas, Carol Butner, then a partner handling mainly medical malpractice and product liability defense cases at Fulbright & Jaworski in Houston, recalls some younger lawyers at her firm cheering. "Well guys, if nobody's going to be filing lawsuits, what do you think you're going to be doing?" replied Butner, who now does intellectual property litigation at McKool Smith.

Roy Camberg, a solo practitioner in Clear Lake, Tex., who built a practice representing plaintiffs in nursing-home abuse cases (also now subject to strict damage limits), says he is simply making less money. In November, he said, he settled a case for \$75,000 that three years ago would have settled for \$375,000. In Beaumont, Provost & Umphrey still bills itself as a personal injury firm. But Umphrey says 25% of his firm's work now involves representing companies in patent suits and other commercial disputes. Lawsuit reform, he says, "changed our direction."

Gwinn & Roby, a Dallas medical malpractice and product-liability defense firm, closed its Fort Worth office in March. Houston's Beirne Maynard & Parsons, which has also worked in those areas, is retooling some of its 90 attorneys. But it has had modest attrition, and partner Martin D. Beirne says: "We're probably going to see some more." Another pressure that firms like his face, Beirne says, is the influx of plaintiffs' attorneys into business practice, which may push hourly rates down as more lawyers compete for the same work.

Sitting in a conference room high over Houston's Galleria neighborhood, James L. Reed Jr. and two other attorneys from Looper, Reed & McGraw contemplate the new legal landscape. Looper Reed's 60 attorneys represent small and midsize busi-

nesses, so one would presume that their clients have benefited from the new environment. But Reed notes that there has been a "ripple effect" from the changes that is affecting commercial cases, too. His colleagues J. Cary Gray and J. Rains, both self-described conservative Republicans, agree.

"It's a hell of a lot harder for one of our clients when a contract gets breached to collect all of their damages," complains Gray, noting that conservative judges take a very narrow view of what kind of damages they will even allow a jury to consider. In general, Gray says, he thinks many Texas judges are "afraid of big verdicts coming out of their courtrooms," even in dispute between businesses. Citing a group of rice producers and Gray represent and the limits they may face on their claims, Reed notes: "They're starting to get educated about how much tort reform is too much tort reform."

That's certainly an idea that would get a sympathetic reception among those who attended the Texas Trial Lawyers Assn. conference. But Amarillo attorney Joe L. Lovell says thanks to the Democrats' strong showing in the November elections, "this was the first kind of upbeat meeting that we had in a long time." Does he think conservatives will now have some of the liability limits reversed? "It brought a lot of people hope," Lovell says, "that perhaps at a minimum, they'll be trying to do any more." ■

Barring the Courthouse Door

View a slide show on the different areas in which business groups have made it harder for consumers to say, "See you in court!"

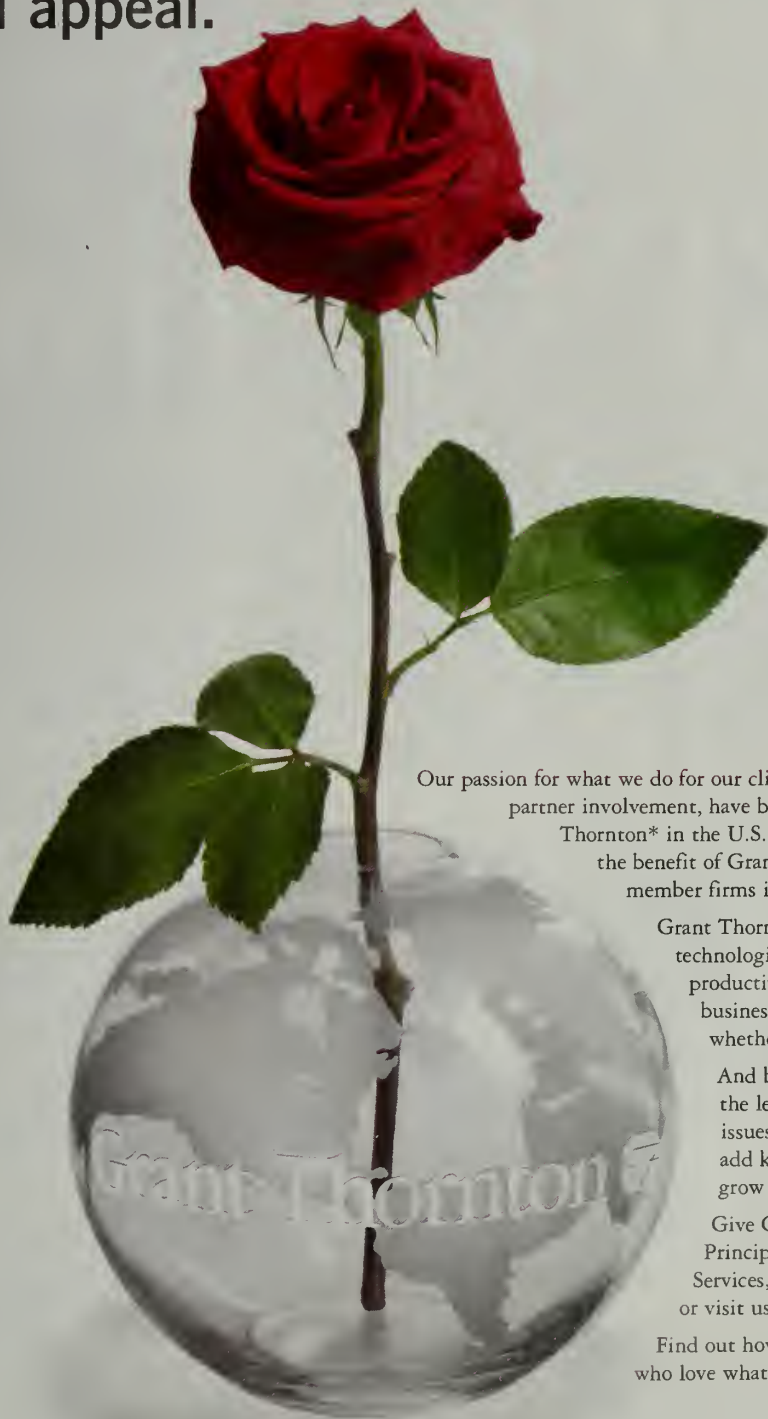
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Decoding ALZHEIMER'S

After a century, promising treatments at last—and whispers of a cure. By Catherine Arnst

FRANCESCO BELLINI HASN'T been sleeping lately. The charged-up chairman of Neurochem Inc. is just months away from finding out if a drug developed by his Quebec-based company can actually slow the course of Alzheimer's disease. A clinical trial of the drug, Alzhemed, will wrap up in January, with results expected in the spring. "The summation of all our work and research for the last 12 years will happen in the next six months," he says.

Those 12 years have been focused on overcoming one of the toughest challenges in medicine: keeping Alzheimer's disease from slowly, relentlessly destroying the brain, something no drug has yet done. The data on Alzhemed have been promising but scant. In a 2002 study it stabilized the disease in nine patients over six months, but the small sample left plenty of specialists skeptical. Not Bellini, a scientist-entrepreneur who discovered one of the first effective treatments for AIDS. He bought a third of Neurochem and took the helm the same year the earlier Alzhemed trial was completed. "I started to feel very good about the drug as soon as I saw what it did for humans," he says.

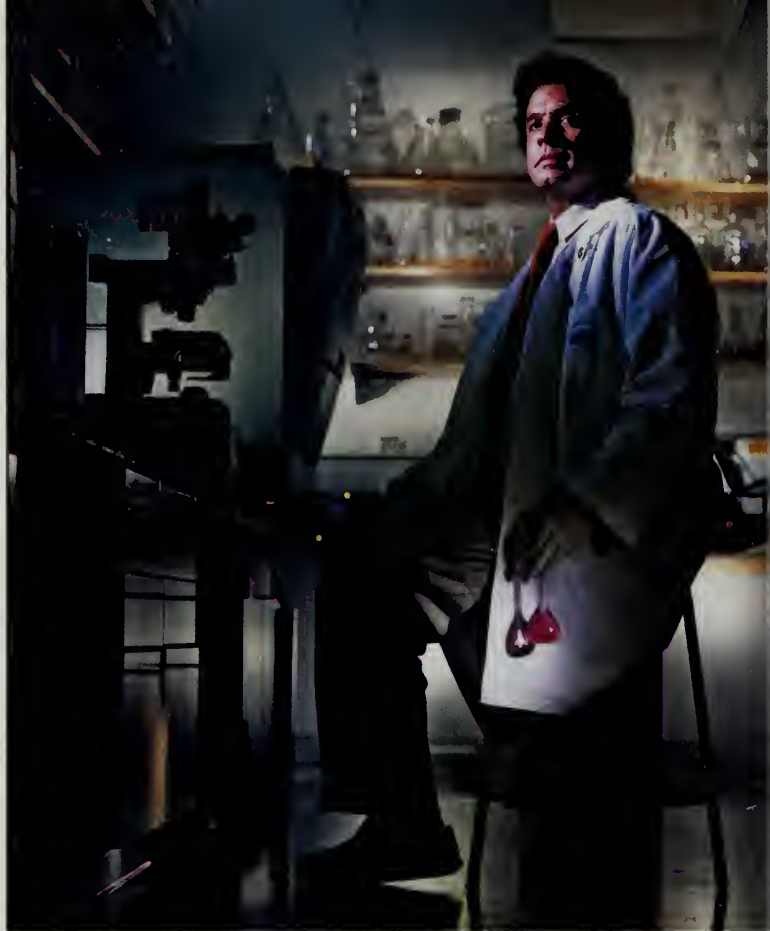
Neurochem quickly moved ahead with a costly late-stage trial, enrolling 1,052 patients with mild to moderate Alzheimer's. There is plenty of debate in the Alzheimer's world over what the results of that trial are likely to be, but a recent follow-up of patients from the previous study found that four were still stable after four years on Alzhemed. In addition, Bellini says every patient who has completed the trial asked to continue the drug—a sign, he says, that it is helping. "I was expecting maybe 30% would ask, but 100%, that's remarkable."



It's not hard to understand why patients would want to continue: They are desperate for hope. Alzheimer's is a frightening trend for an aging population. One in 10 people over the age of 65 develops the disease. Over age 85, the odds rise to one in two. The diagnosis is an agonizing death sentence, as it takes anywhere from 3 to 20 years for Alzheimer's to kill—and it always does. The Alzheimer's Assn. estimates there will be 9 million Americans with the disease by 2020 and 15 million by 2050. If there are no disease-modifying drugs by then, the cost of care will top \$1 trillion.

Whether or not Alzhemed works as hoped, its very existence is just one reason the outlook for Alzheimer's drug discovery is turning, finally, more positive than negative. A century after the disease was first identified, scientists are closing in on medicines that can safely delay or reverse its onset. The burden of proof doesn't rest solely on Alzhemed, either. Flurizan, a drug developed by Myriad Genetics Inc., is also in a late-stage trial, with results expected next summer. A few years behind Alzhemed and Flurizan are promising treatments from Wyeth Pharmaceuticals and Eli Lilly & Co. that provoke an immune response against the disease. Nearly 60 other drugs designed to modify the disease are also in clinical trials, including one from AC Immune of Switzerland that caught the attention of biotech giant Genentech Inc., best known for its cancer treatments. Genentech just announced plans to invest \$300 million for the rights to AC Immune's drug. "It's a whole new era," says Dr. Serge Gauthier, director of Alzheimer's research at McGill University's Center for Studies in Aging. "At least some of these medications are likely to work, and once we have disease-modifying drugs, we have opened the door to prevention."

It's particularly striking that the science is advancing despite a long-standing dearth of investment in Alzheimer's research. There are currently 4.5 million Alzheimer's patients in the U.S., and the direct and indirect costs of caring for them total more than \$100 billion a year, making Alzheimer's the third most expensive illness after heart disease and cancer. Yet the federal government budgeted only \$645 million for



"I can't imagine a more incredible puzzle to solve," says Mass General's Tanzi

Alzheimer's research for 2007, \$7 million less than the previous year. In contrast, \$2.6 billion was allocated for research in HIV/AIDS, which afflicts one million Americans.

The massive funding pumped into HIV research led to predictable results: AIDS was transformed from a death sentence into a manageable disease in just 10 years. Scientists say the same could happen with Alzheimer's if there were a similar national will. "Look, if we doubled our research output it would halve the amount of time it will take to find a cure," asserts Dr. Leon J. Thal, director of the Alzheimer's Disease Research Center at the University of California, San Diego.

A Long Time Coming

One hundred years ago, Dr. Alois Alzheimer identified the ailment that bears his name. Scientists are now decoding the disease and testing drugs that could delay and maybe even cure Alzheimer's.

1992-93 Scientists identify several genes that predispose people to develop Alzheimer's disease.

1986 Researchers discover the composition of the protein tangles found in the diseased brains.

1993 Cognex' Tacrine becomes the first drug to win FDA approval for alleviating symptoms of Alzheimer's. It later falls out of use because of liver toxicity.

1984-85 Scientists identify the chemical composition of the amyloid deposits that clog the brains of Alzheimer's victims.

If we doubled our research...it would halve the...time it will take to find a cure.” —Dr. Leon J. Thal

Certainly any disease could benefit from more funding, but with Alzheimer's the need for effective treatments is especially urgent. It is the only major cause of death in the U.S. where the numbers are getting worse, not better. That's because Alzheimer's is a disease of success. As people live longer and benefit from new treatments for common killers such as heart disease and cancer, the odds they will succumb to Alzheimer's increase. Proving the point, Los Angeles County just reported that deaths there from heart disease dropped 29% between 1988 and 2003, and from lung cancer by 19%. But deaths from Alzheimer's soared 220%.

Given the trend lines, any drug that ameliorates the disease is certain to be an instant blockbuster. Investment advisers at Morgan & Co. calculate that if just a few of the medicines in clinical trials pan out, U.S. demand for Alzheimer's drugs could reach \$10 billion to \$15 billion annually, up from about \$3 billion now.

The market will be even larger if these new drugs are used by millions of senior citizens with faulty memories, a condition called mild cognitive impairment (MCI) that significantly increases the odds of developing Alzheimer's. The hope of every drug developer out there is that a successful Alzheimer's treatment may be able to prevent the disease from occurring in these higher-risk patients. "The MCI market is huge—20 or 30 million people," says Neurochem's Bellini.

The changing outlook for Alzheimer's is particularly striking because, unlike heart disease and cancer, there has been no gradual evolution from good drugs to better. The Food & Drug Administration has approved only five medicines for the disease, the last by Pfizer Inc.'s Aricept. All relieve only some memory loss, for a few months, in some patients. Until recently, neither large pharmaceutical companies nor venture capitalists showed much interest in funding research into more effective drugs, given the low success rate. With no proven treatment, or even a proven cure, Alzheimer's research seemed just too risky.

The U.S. government has no plans to put together the equivalent of a moon shot to cure the disease. But a critical mass of committed scientists, philanthropists, and maverick

entrepreneurs has come together and put forth new scientific approaches and new funding sources to push the field forward. The result: For the first time, scientists are beginning to whisper the word "cure."

PAST AND PRESENT

Rudolph E. Tanzi, a boyish-looking 47, ended up in Alzheimer's research in the early 1980s after he realized he probably wasn't going to make it as a rock star. Having recently graduated from the University of Rochester, he quit his band to work on the genetic causes of brain diseases at Massachusetts General Hospital. He earned a PhD from Harvard University, and in 1987 his team discovered a gene that plays a key role in the start of Alzheimer's, solving a central mystery of the disease.

*Today, Tanzi is director of the Genetics & Aging Research Unit at Mass General's Institute for Neurodegenerative Disease, working with some 200 other researchers, several hundred mice, and his wife, Dora Kovacs, who studies the role of inflammation in Alzheimer's. Tanzi has started two companies to develop drugs based on his findings, written dozens of scientific papers, and still found time to pen a layman's history of Alzheimer's research, *Decoding Darkness*, published in 2000. "I can't imagine a more incredible puzzle to solve," he says.*

The solution has been a long time coming. Alzheimer's was first identified at a medical meeting in Germany in 1906 by a Bavarian neurologist, Dr. Alois Alzheimer. He described a patient, Auguste D., whom he started treating for madness when she was 51. She died five years later, and when Dr. Alzheimer autopsied her brain he discovered it was riddled with sticky clumps and fibrous tangles. For the first time, dementia was classified as a distinct disease rather than a form of insanity, and there the science remained for 78 years.

It wasn't until 1984 that scientists figured out that those clumps are made of a protein found throughout the body called amyloid. The discovery gave birth to the amyloid hypothesis, which holds that the accumulation of amyloid plaque in the brain slowly destroys brain cells. This is still very much

a theory. Some experts contend that the excess amyloid may instead turn out to be a by-product of some earlier disease process that already took hold of the brain. "Many in the field find the evidence behind the amyloid hypothesis compelling, but we can't exclude the possibility that other targets play an important role," says Dr. Richard A. Hodes, director of the National Institute of Aging (NIA). "It's critical that we not put all of our efforts in that domain."

Nevertheless, drugs targeting amyloid are much further along than any other approach be-

1996 Aricept, a Tacrine-like drug with fewer side effects, wins FDA approval. Three other drugs for symptoms have since gotten the green light.

2004 Wyeth and Elan report that their Alzheimer's vaccine reduces the plaque in the brains of Alzheimer's patients. The trial was halted because some patients developed encephalitis.

2006 More than 60 Alzheimer's drugs are now in human testing.

2005-96 Researchers genetically engineer mice to develop a disease that resembles Alzheimer's—an important step in drug discovery.



Name me one person who sooner or later doesn't worry about getting it." —Leonard Lauder

cause the amyloid process has been at least partially decoded. The gene discovered by Tanzi 20 years ago starts the process, creating a large protein called APP. Found in almost every cell of the body, APP sticks halfway out of the cell wall. Two scissor-like enzymes cut away a fragment of this molecule, which then floats away to facilitate communications between other cells. But for unknown reasons, these fragments sometimes go awry and become toxic.

In the brain, normal amyloid fragments are 38 to 40 mol-

ecules long. But in the mid-1990s scientists discovered that the wayward snips consist of 42 molecules. Those extra 4 molecules cause the amyloid fragment to fold in on itself until it looks like a bobby pin. As more and more bobby pins are formed, they become entwined, creating clumps called plaques.

The vast majority of Alzheimer's drugs in development target A-beta 42, as this overgrown fragment is known. There is wide variation in their methods, however. Some seek to reduce its production, while others try to keep it from accumulating into plaque. Tanzi and an Australian colleague, Ashley Ian Bush, came up with a "chelating" agent that washes A-beta 42 out of the brain before it can clump together.

Their drug is based on Bush's discovery that traces of zinc, copper, and iron prod amyloid form into plaque. The two found a compound that removed those metals from the brain and caused amyloid levels to drop in mice. Tanzi then teamed up with a pioneering Alzheimer's scientist, Colin Masters, in 1997 to form Prana Biotechnology Ltd. in Victoria, Australia.

Coming up with the money for a drug start-up is never easy, and Alzheimer's is on the bottom of venture capitalists' to-do lists. But Bush had a deep-pocketed friend in Australia who was looking for a new adventure. Geoffrey Kempner, 50, CEO of Prana, made his millions by securing the Australian rights to the Aveda line of beauty products. Fueled by a combination of "naïveté and enthusiasm," as he puts it, he spent a few million dollars getting Prana off the ground before its initial public offering in 2000.

Prana's metal-removing drug was tested on 36 patients in 2003, and it successfully lowered amyloid levels. But in April, 2005, problems with the drug's purity forced Prana to stop the program. The share price sank from \$4 to within days.

As it happened, Prana was working on a successor treatment designed to be safer than the first. Although still in shock over the blow to market value, "we actually put our foot on the accelerator," says Kempler. The second drug successfully completed an initial safety study in 2005, and in December Prana started a large trial with 80 patients in Sweden. If all goes well, the drug could reach the market in five years, says Kempler. The stock price, meanwhile, has risen to around \$3 a share.

Tanzi is not counting on Prana alone. Alzheimer's is such a complex disease that many experts anticipate giving patients a cocktail of drugs, much as they treat AIDS. Tanzi says he is willing to license his discoveries to any company seeking to develop an ingredient of that cocktail. Toward that end, in 2000 he co-found-

The Path to a Cure

Dozens of drugs designed to treat, delay, or prevent Alzheimer's disease are in clinical trials. Here are a few:

DRUG	MODE OF ACTION	TRIAL STAGE
ALZHEMED Neurochem	Prevents the accumulation of amyloid, a toxic protein that destroys brain cells in Alzheimer's victims	Phase 3 late-stage testing
FLURIZAN Myriad Genetics	Inhibits production of amyloid	Phase 3
HUPERZINE A Neuro-Hitech	Strengthens memory formation and may protect brain cells from damage caused by Alzheimer's	Phase 2 mid-stage testing
MEM 1003 Memory Pharmaceuticals	Evens out irregularities in brain levels of calcium—one of the first manifestations of Alzheimer's	Phase 2
AAB-001 Wyeth/Elan	Monoclonal antibody (a bioengineered protein) that seeks out and removes amyloid in the brain	Phase 2
LY450139 Eli Lilly	Blocks an enzyme that snips off amyloid fragments, thus reducing the production of amyloid	Phase 2
PBT-2 Prana Biotechnology	Clears trace metals from the brain that enable amyloid molecules to accumulate	Phase 2
AL-108 Allon Therapeutics	Bolsters a protein that repairs and protects brain cells from damage	Phase 2
ACC-001 Wyeth/Elan	Vaccine that prompts the body's immune system to attack and remove amyloid in the brain	Phase 1 early safety tests
CERE-110 Ceregene	Gene therapy that increases production of a nerve growth factor that protects brain cells	Phase 1



Lauder, a cosmetics exec by day, is an Alzheimer's warrior during off hours

reyPines Therapeutics Inc. in La Jolla, Calif., to work out compound that lops off the amyloid fragment at the 38th molecule instead of the 42nd, rendering it harmless. This year, Tanzi started work on his biggest project yet: identifying all the genes involved in Alzheimer's. He predicts will have a genetic blueprint in hand within two years and genetic test within five. Tanzi doesn't have to scrape around cash this time, either. The Cure Alzheimer's Fund, founded three Boston area families, pledged \$3 million to his lab this genetic detective work, stepping in where the NIA and venture capitalists refuse to tread.

PHARMA PARTNERS

In 2000, Wyeth CEO Robert Essner bucked a pharma industry trend and made Alzheimer's a research priority. It wasn't his idea. Essner, who came out of the marketing side of the business, was hooked into a partnership with Elan Corp. by Wyeth scientists enamored with the Irish company's vaccine for treating Alzheimer's, which they thought was the most promising treatment out there. The scientists warned Essner it would take three years and \$100 million just to get the treatment into human clinical trials. They also conceded that they couldn't even hazard a guess at the likelihood of success, the odds were so low. Essner took the leap anyway: "Our scientists were so passionate that if I had turned them down, they would have had a mutiny."

Five years on, Essner figures Wyeth has spent more than twice as much as it estimated \$100 million. He has also made the concept behind the vaccine—that the immune system can be primed to fight off amyloid—the centerpiece of Wyeth's Alzheimer's program.

In the spring of 2002, Elan and Wyeth scientists were im-

mersed in clinical trials of the vaccine. But in March they were forced to halt the trials when 15 of 300 patients developed encephalitis, a dangerous swelling in the brain. A deep gloom spread through the Alzheimer's research community. The Elan-Wyeth drug was the first to "cure" the disease in mice, but the risk of encephalitis forced doctors to halt human tests.

The researchers didn't give up. When they examined the blood of several patients in the trial, they saw that the vaccine had produced antibodies against the amyloid, as it was meant to do. In the fall of 2003, the companies announced that the autopsied brains of four vaccine recipients who had died of other causes had no amyloid plaque. A few months later, Swiss doctors reported that 19 of 28 patients treated with the vaccine had produced antibodies against amyloid, and 12 of those 19 either improved or stabilized their performance on memory tests—the first proof of principle that clearing amyloid could alter the disease in people.

The vaccine, a safer version of which is now in early-stage trials, calls for a patient to be injected with a tiny piece of the A-beta 42 protein found in deadly plaque. The injected fragment prompts the body to produce antibodies, which seek out and destroy more of the offending A-beta molecules. But tampering with the immune system can stir up unfortunate side effects, such as encephalitis. It's safer to send

in some handpicked soldiers instead, otherwise known as monoclonal antibodies. The Wyeth/Elan partnership created such a lab-built antibody to target the same molecule used in the vaccine experiments, A-beta 42.

When injected into a patient, the antibody locates and destroys amyloid fragments without activating the immune system. Data released last spring from the first human trial of the drug, called AAB-001, showed that patients performed significantly better on memory tests, and there was reduced plaque in autopsied brains. Results from an ongoing Phase 2 trial are expected in early 2007. If positive, the company is likely to move into final testing quickly, putting the drug on track for FDA review by 2010. Meanwhile, Wyeth's strategy has attracted the sincerest form of flattery: Eli Lilly, Pfizer, and now Genentech are all developing amyloid antibodies.

There are also dozens of startup companies with intriguing anti-amyloid drugs. "We've got 30 to 50 drugs in Phase 2 and eight or nine in Phase 3," says William Thies, the Alzheimer's Assn.'s vice-president for medical relations. "They've passed an awful lot of hurdles. I believe some will work, and we will keep developing better and better medicines."

SOLDIER WITH FORTUNE

Leonard Lauder, the 73-year-old chairman of Estee Lauder Cos., is an elegant man with an elegant office. He works in a robin's-egg-blue room high up on Fifth Avenue with a to-die-for view of Central Park. Around his desk are artworks by Richard Serra, Agnes Martin, and Claes Oldenburg, and his large coffee table is covered with fashion magazines and lavish art books. All this beauty represents his "day job," as he puts it. In off hours, he is determined to find a cure for Alzheimer's. His reason is simple:

Once we have disease-modifying drugs, we have opened the door to prevention.” —Dr. Serge Gauthier

“Name me one person who sooner or later doesn’t worry about getting it.”

Lauder is not content to use his fortune, estimated at \$2.9 billion, to bolster long-standing Alzheimer’s charities. In 1998 he and his younger brother, Ronald, founded the Institute for the Study of Aging solely to turn promising Alzheimer’s research into commercial drugs. To date, the institute and an affiliated public charity have funded 167 projects, spending \$25.5 million. “We figured that if we put enough money into it and backed enough ideas, we had a pretty good shot at coming up with a cure,” says Lauder.

With the meager public funds available for Alzheimer’s research, a scientist with a good idea must scramble for money. The Lauders’ foundation aims to ease the burden. The two brothers knew how frustratingly slow the hunt has been for an Alzheimer’s drug, and thought a venture philanthropy that focused on drug discovery rather than basic research might be able to close the gap between the two. They hired Dr. Howard Fillet, a renowned geriatrician who had treated their mother at Mount Sinai Medical Center in New York (Estee Lauder died of heart failure in 2004) and told him to forget about requiring complex grant proposals. “They gave me an office, a desk, and a pot of money,” says Fillet, the institute’s director. “I go to meetings, hear an interesting presentation, and tell the scientist, ‘Call me. I’ll give you money.’”

That’s the story behind Allon Therapeutics Inc. in Vancouver. Some five years ago, Allon’s founding scientist, Ilana Gozes of Tel Aviv University, had collected meager funds from friends and family to finance her research into a protein fragment necessary for brain formation. She had a hunch the fragment might shield neurons from the damage inflicted by Alzheimer’s.

Gozes was just starting her company when Fillet learned about her work. Based on a few conversations, he handed her \$350,000. “No one else would have made an investment at that point,” says Allon CEO Gordon C. McCauley, who came on board in 2004 when his venture capital fund provided the next round of financing. Allon’s treatment has since proven safe in people and is about to enter a larger trial. And Allon has enough capital to keep the trials going—the company went public in 2004.

JUST THE BEGINNING

Dr. Paul S. Aisen oversees the care of some 1,000 Alzheimer’s patients as director of the Memory Disorders Program at Georgetown University School of Medicine, and there is little he can offer

them. Consequently he is willing to test any reasonable-sounding experimental treatment that comes along, and his program is one of the nation’s leading centers for Alzheimer’s trials.

Unfortunately, clinical trials often turn into exercises in futility since fewer than 10% of experimental drugs survive the three-stage process to win FDA approval. Aisen knows this all too well. He spent 15 years testing anti-inflammatories such as Aleve and Vioxx against Alzheimer’s because studies seemed to show a link between the popular drugs and a lower incidence of the disease.

But in 2003 he admitted defeat after a rigorous trial found that anti-inflammatories did no good. He published the results and moved on, searching for something else that would work. “It is the patients’ plight that gives everyone on our team a great appreciation for the tremendous need for better treatments,” says Aisen.



Georgetown’s Aisen is encouraged by trials of China’s Huperzine A

Today, Aisen is the lead investigator for Alzhemed. His clinic is also running trials on Flurizan, antibodies from Wyeth/Elan and Lilly, and the generic anti-seizure medicine Valproate. But he’ll look far afield from advanced biotech labs for treatments. That’s why he is testing a drug derived from Chinese moss that has been used for more than 2,000 years in the Middle Kingdom to treat fevers.

Aisen learned in 1999 that doctors in China had been using the drug, called Huperzine A, for some 20 years to relieve symptoms

of Alzheimer’s. Now made by Neuro-Hitech Inc., the drug improves memory in much the same way as Pfizer’s Aricept and other existing Alzheimer’s treatments, without the gastrointestinal problems associated with these older drugs. But Aisen was most intrigued by evidence that, in mice, Huperzine protected brain cells from the ravages of plaque and tangles something the other drugs can’t do.

Aisen is now in charge of a mid-stage trial of Huperzine A. But he does not expect it, or any of the drugs he is testing, to be the definitive cure the world craves. Ultimately, scientists and physicians say today’s research is laying the groundwork for treatments that can prevent Alzheimer’s from taking hold in the first place. “I’m hoping we’ll put ourselves out of business in 20 years,” says Dr. Reisa A. Sperling, head of Alzheimer’s clinical trials at Brigham & Women’s Hospital in Boston. “I’m 47, and before I retire, I believe I’ll be looking for another disease to study.” ■

BusinessWeek .com For a slide show on things you can do that might and won’t, lower the odds of developing Alzheimer’s disease, go to www.businessweek.com/extras.

Precision and commitment dominated the 2006 Platts Global Energy Awards

The companies and individuals who consistently set a high standard of excellence within the energy industry in 2006 were honored as Platts Global Energy Awards' winners at a black-tie gala at Cipriani Wall Street in New York City on Thursday, November 30, 2006.

2006 Platts Global Energy Awards winners are:

CEO of the Year

Ignacio Sánchez Galán of Iberdrola

Global Energy Project of the Year

Hydro

Commercial Technology of the Year

CURRENT Communications Group

Hydrocarbon Producer of the Year

Williams

Community Development Program of the Year

EcoEléctrica

Industry Leadership Award

Duke Energy

Downstream Business of the Year

Anonima Petroli Italiana SpA (API)

Lifetime Achievement Award

Paul M. Anderson of Duke Energy

Emissions Energy Project of the Year

Arizona Public Service Company
and GreenFuel Technologies Corporation

Marketing Campaign of the Year

S-Oil Corporation

Energy Company of the Year

Iberdrola

Petrochemicals Company of the Year

SABIC

Energy Pioneer Award

EnerNOC, Inc.

Power Company of the Year

ENDESA

Energy Transporter of the Year

PJM Interconnection

Rising Star Award

Hercules Offshore, Inc.

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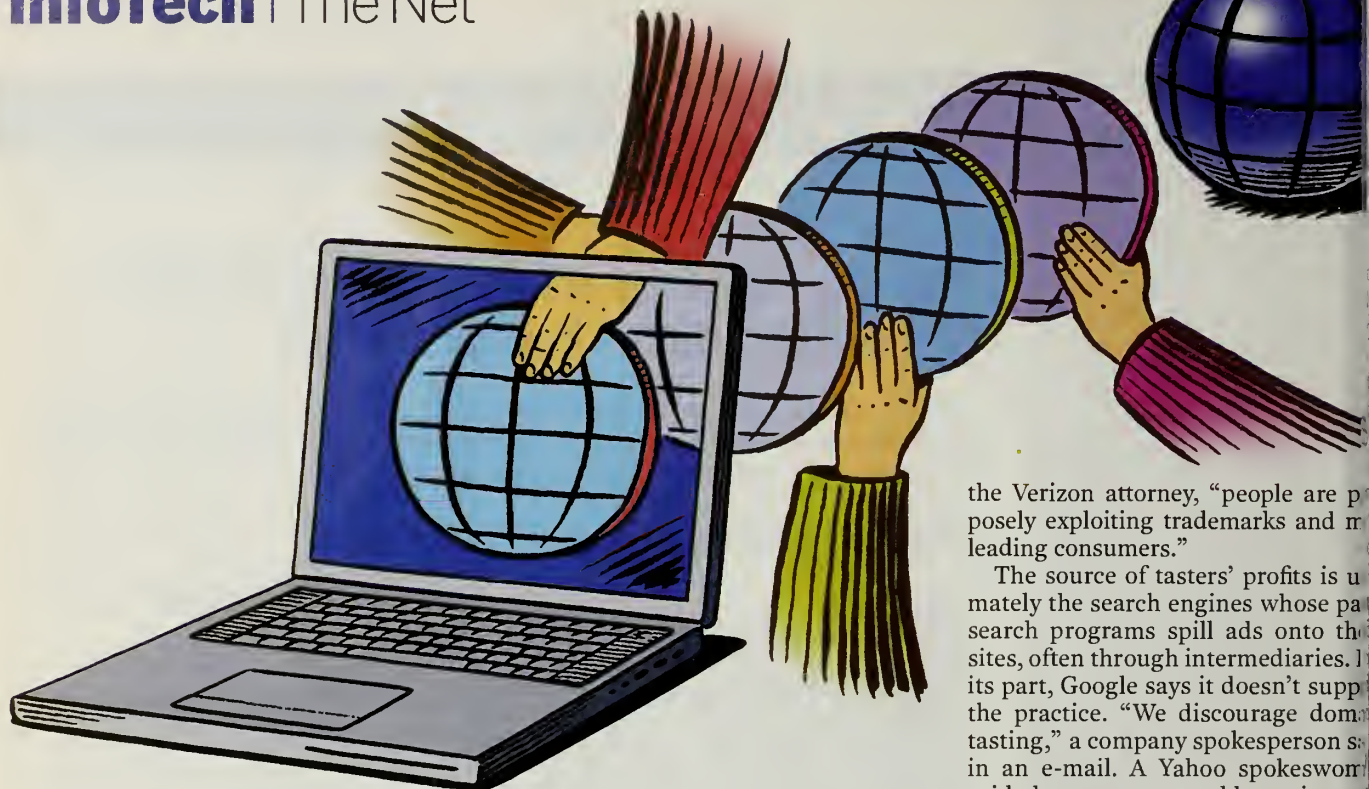
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See Anything Odd About 'Vorizon'?

How temporary Web sites cash in on such names as Verizon and Dell

BY MOIRA HERBST

SARAH B. DEUTSCH IS steaming. The Verizon Communications lawyer regularly scours the Web from her Arlington (Va.) office and finds hundreds of new sites that use variations of Verizon's name. A mid-December browse uncovers domain names such as verizonpicture.com, vorizonringtone.com, and varizoncellularphone.com. But none of the sites has anything to do with Verizon. They're registered by companies such as Wan-Fu China Ltd. in Nassau, the Bahamas, and Maltuzi Holdings in Mountain View, Calif.

Blame it on a little-known but rapidly growing activity called "domain tasting." The practice, perfectly legal, lets registrars profit from the complex money trail of pay-per-click advertis-

ing. Exploiting a regulatory loophole, "tasters" snatch up Internet domains for five days at no cost and jam them full of advertisements filtered down from Google and Yahoo! That means the taster vorizonringtone.com gets cash every time a visitor clicks on an ad like one for Cingular found on that site in the last week of December. With zero risk and 100% profit margins, bulk registrants are now registering mass quantities of domain names every day—some of them over and over again. A Cingular spokesperson said the company's advertising team members were not immediately available for comment. According to Deutsch,

the Verizon attorney, "people are purposely exploiting trademarks and misleading consumers."

The source of tasters' profits is ultimately the search engines whose paid search programs spill ads onto the sites, often through intermediaries. In its part, Google says it doesn't support the practice. "We discourage domain tasting," a company spokesperson said in an e-mail. A Yahoo spokeswoman said the company could not immediately comment.

In late 2004, roughly 100,000 domain names were being sampled on any given day. Now the number is 4 million a day, says Jay Westerdal, CEO of consulting firm Name Intelligence Inc. Experts estimate that less than 2% of the sites that are tried out for a few days are ultimately purchased by registrants. It's a bit like being able to get clothes from a store to wear them for five days, then return them at no charge. And with more than 200 suffixes besides ".com" to choose from, there's no end in sight.

The explosion in domain tasting can be traced back to the practices and policies of the organization responsible for regulating Web names, the Internet Corp. for Assigned Names & Numbers (ICANN). In 2000, ICANN established the "create grace period," a five-day stretch when a company or person can claim a domain name and then return

it for a full refund of the \$6 registry fee. That was to allow someone who mistyped a domain to return it without cost.

Now a growing chorus of critics is crying foul. Verizon, Time Warner, Dell, and others are calling ICANN to change its practices. In June, the Neim Marcus Group Inc. brought a federal lawsuit against Dotster Inc., one of the largest domain-name r

THE STAT

4 million

Number of Web domain names tried out per day

Data: Name Intelligence Inc.

It's about money. Earning it. Investing it. Spending it.



ars, alleging that Dotster participated in a massive campaign of domain tasting and other activities targeting companies such as Google, Playboy Enterprises, and Walt Disney. David J. Steele, a lawyer with Neiman Marcus, likens regulating domain names to gun control. "Are guns awful to own? No," says Steele. "But they can be used for unlawful purposes. So can the system of domain tasting." Dotster did not return calls for comment on the suit.

CANN says it is not its place to change practices of registering domain names. Tim Cole, chief registrar liaison for the organization, says its constituents should make a clear proposal to change policy so that ICANN's board of directors can consider adjusting it. "We're definitely taking action to inform the community about the issues involved, but it's up to them to decide what they want to do," he says.

PS, WRONG ADDRESS

EXECUTIVES AT domain-tasting companies maintain that they can provide a service. For example, if a Web surfer mistypes a Web address and lands on one of their sites, the companies can have an ad that directs the surfer to the proper site. T. Sassen, manager of Maltuzi, says his company is a "bulk registrant" of domain names, and says there's nothing wrong with that. He writes in an e-mail interview: "We... chase those domain names which have high traffic levels or pay-per-click visibility and return those which do not meet these and other criteria."

Other powerful forces oppose changing the system. VeriSign Inc. controls the .com and .net names and sells them to various companies. Michael Deng, general manager of digital brand management services, says VeriSign is against any abuse of domain tasting but is not advocating the elimination of the five-day grace period, because it can sometimes be legitimate.

Critics say VeriSign likes the status quo because it makes so much money from it. The float from those \$6 deposits is piling up. And VeriSign recently launched a new product called "digital brand and fraud protection" that in part helps corporations combat trademark infringement through practices like this. The service costs \$100,000 to \$200,000 a year.

Verizon's Deutsch compares domain tasting to "a feeding frenzy" and says legislation may be needed to stop the spree. "Tasters aren't adding anything to the Internet but instability," she says. ■

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The Borat Of Wall Street

Amit Chatwani's Leveraged Sell-Out blog lampoons the twentysomething banker set



BY ROBEN FARZAD

IT'S LATE AFTERNOON AT A BAR in the heart of Manhattan's financial district. This being early December, the place is buzzing with chatter about Wall Street's gangbuster yearend bonuses. In walks a 24-year-old banker type in a crisp London-tailored shirt and tie, sporting diamond-studded cuff links (or are they cubic zirconium?) the size of Danish butter cookies. He struts past a group of women like an urban peacock. "The bridge and tunnel crowd," he says, dismissing them as groupies from New Jersey and other hinterlands. Then he turns his gaze to this reporter. "I'm surprised they let you in with that blazer."

Just another day not at the office for Amit Chatwani, the man behind Leveraged Sell-Out (www.leveragedsellout.com), a blog that riffs on the absurdities

of the twentysomething Wall Street set. A strategy consultant and Web entrepreneur by day, Chatwani moonlights as the Borat for bankers, assuming the on-line persona of obnoxious young striver to skewer the rarefied yet intensely insecure demographic.

Launched in September, 2005, the blog has caught fire, generating 120,000 page views a month. The success convinced Chatwani to court advertisers via Google's AdSense program. Now, as if oblivious to the site's mocking tone and abundant profanity, financial recruiting firms and boutique banks pay as much as \$10 a click, according to Chatwani, for dibs on certain keywords. He's even shopping around a book proposal with an agent.

All vanities, from dating prerequisites to sartorial obsessions, are subject to Chatwani's ridicule. Witness the glee his alter ego feels on picking up a car-service

voucher after an 18-hour day: "I already see myself inside, laughing at hoi polloi walking to their subways taking their yellow taxis. I can already feel the cheap leather I pretend is expensive massaging my aching buttocks." how he looks down on Goldman Sachs workers donning Men's Wearhouse suits: "Do they not know how much an embarrassment they are to the world's premier investment bank?"

CONSPICUOUS CARICATURE

THE NEFARIOUS PERSONA began to take shape when Chatwani drafted a widely forwarded mock cover letter to Lehn Brothers Inc. during his senior year at Princeton in 2004. "I have been practicing staring at a computer monitor for extended hours," he wrote. "I can currently sit motionless in front of a screen for hours, and I am improving daily."

The computer science grad moved to New York later that year, where he settled with 10 cub investment bankers in a Tribeca loft and marinated in the vernacular and rituals. He found himself invited to yearend bonus parties of Diddy-esque profligacy. Chatwani reveled at how conspicuously guys wove their firms' ID badges to get a leg up in the shallow mating game. And how questionable Wall Street relationship time consisted of stealing away from the office

HOT PROPERTY

Chatwani says advertisers now pay up to \$10 a click to be on his site

a week to share an hour of TiVo. Chatwani says paranoid bankers e-mailed together an intricate spreadsheet to handicap co-workers' likely bonuses.

It all became fodder for what Chatwani calls his "consumer banker caricature." The site's most popular post told the tale of two gold-digger Jersey girls coming to Manhattan on a hell-bent mission for their dream bankers. "It got read way more than I had expected," he says. Lately, he's been finding fun at young bankers' penchant for exorbitant bottle service at nightclubs.

For all the lampooning, though, Chatwani empathizes with his subjects. "It's weird," he says, fidgeting with a cuff link. "People know Wall Street is going to suck. They know they'll work 100-hour weeks. A lot of them just didn't know there was much else to do but go into banking." Recruiters would credit his advice to undergrads considering a career on the Street: "If you want to make money and don't really care about working a boatload or doing something creative, then it's the ideal job." ■



Saving Private Ryan From Greedy Lenders

A congressional crackdown on gouging soldiers creates a new regulator: The Pentagon

BY DAWN KOPECKI

THE DEFENSE DEPT. IS about to become a major financial regulator, and that's throwing lenders for a loop. Pentagon officials and consumer advocates pushed Congress this summer to help the many thousands of service members incurring excessive debt, some of whom have lost security clearances as a result, making them ineligible under Defense rules for deployment to Iraq. The main culprit, the Pentagon said, are so-called payday lenders, which cluster around military bases and charge as much as 800% interest to provide soldiers with cash advances against their paychecks. Congress gave the Pentagon broad new authority to cap interest rates on most consumer loans to more than 1.4 million active-duty personnel and their families. Not surprisingly, payday lenders objected that they will be hurt and that their customers, who often have poor credit, will be left with no place to turn. Now even mainstream lending institutions and traditional financial regulators say they fear the hastily written

law will have unintended consequences. "From our perspective, the scope of the measure that was enacted is so broad that we're still trying to get our arms around it," says Diane Wagner, a spokeswoman for Bank of America Corp. Among the uncertainties: whether the law applies to existing loans, and also what happens when any of the

Financial Firepower

Last fall the Defense Dept. won the power to regulate companies that lend to military personnel. A new law lets the Pentagon:

- Set a limit of 36% on annual percentage rates, including all fees, on loans to service members
- Require lenders to provide separate and enhanced disclosures for the military
- Impose tough sanctions, including jail time, for lenders who violate the law

1.2 million reservists or National Guardsmen are called to active duty.

Lenders and regulators say the measure's rate caps put in doubt the legality of debt consolidation loans, credit-card cash advances, student loans, overdraft protection, and other types of finance for soldiers and their dependents. "Every day a lightbulb goes off in the lending community with ways this could limit or restrict credit to our military," says Andrew Barbour, a lobbyist for the Financial Services Roundtable, which represents such institutions as Wachovia, American International Group, Merrill Lynch, and Capital One Financial.

WHOSE RESPONSIBILITY?

KEVIN MUKRI, SPOKESMAN for the Office of the Comptroller of the Currency, which regulates national banks, adds: "To my knowledge, this is unprecedented—giving consumer credit regulation to the Defense Dept. I wouldn't know how to write a regulation for bombers."

Outgoing Senate Armed Services Committee Chairman John Warner (R-Va.), however, stands by the law, which he backed. "Congress has an absolute responsibility to protect members of the military and their families from such unfair practices," says a spokesman.

The law, which was attached to a defense bill last fall and will take effect on Oct. 1, 2007, establishes a 36% cap on interest rates for most loans to military members and their families. Unlike most credit regulations, the new law requires the annual percentage rate for military loans to include all fees. Factoring in fees can push the APR beyond the law's cap. Home mortgages, auto loans, and credit secured by personal property are exempt.

Lenders say stiff penalties for violations of the new law may scare off institutions. If a lender unwittingly provides a loan with an improper rate to a service member's spouse, the loan becomes invalid and doesn't have to be repaid. If the lender "knowingly" violates the law, it is subject to fines, and its employees can even get jail time. Avoiding these missteps could be complicated by separate laws that prohibit lenders from asking about marital status.

One lender worrying about such ambiguities is Cooperative Bank in North Carolina, which serves Marines and their families at Camp Lejeune, south of the Outer Banks. CEO Rick Willetts says of the new law: "This is a well-intended idea that is opening Pandora's box." ■

Making Her Mark At Merck

Margaret McGlynn, critical to a post-Vioxx turnaround, is on a fast track

BY ARLENE WEINTRAUB

FOR MERCK'S MARGARET G. McGlynn, developing drugs is a deeply personal pursuit. As a child growing up in Buffalo, she learned early about the ravages of disease after three of her seven brothers and sisters died in childhood—one of measles before McGlynn was born and two of a rare genetic disorder. She was four years old when the measles vaccine was introduced, and as her mother drove her to a mass-immunization clinic,

she reminded her of the child they'd lost. "I was a real believer that vaccines have a critically important role," says McGlynn.

Today vaccines have a critical role in Merck & Co.'s turnaround effort, and McGlynn is right in the thick of it. The drug giant has launched four new vaccines since McGlynn took over as president of Merck Vaccines in September 2005. Among them is Gardasil, hailed as a breakthrough because it prevents some forms of human papilloma virus (HPV), a leading cause of cervical cancer. Merck rolled out Gardasil in July for females aged 9 to 26, with marketing focused on educating patients about the link between HPV and cancer. The product brought in \$80 million in the first months—a debut that CEO Richard Clark says beat expectations. When asked if McGlynn, 47, could be a CEO candidate one day, Clark says: "Absolutely. She's definitely CEO material."

McGlynn, a pharmacist who started at Merck as an intern in 1981, is helping to restore some luster to the company's tarnished record. After its \$2.5 billion-a-year arthritis medication Vioxx was yanked from the market in late 2004 because of cardiovascular side effects, Merck set out to slash costs and improve the way it develops and markets drugs. Merck

PERSUASIVE A former boss calls McGlynn "relentlessly logical and wonderfully intense"



cts to report 2006 earnings of at least .4 billion before special charges—ightly exceeding the estimate Clark ve at the beginning of the year—on es of \$22 billion. Investors pushed erck's stock up 36% in 2006, to 43. alysts are counting on McGlynn to ve much of Merck's growth: Some edict revenues from her division will ole by 2010, to \$6 billion.

Early on, McGlynn proved that she ild churn out hits. As a product nager in the late 1980s, she turned erck's treatment for high blood ressure, Vasotec, into the company's first billion product. Her strategy stressed at the drug was also approved to treat ggestive heart failure—an advantage ncompetitors couldn't yet match. When McGlynn spotted rivals working on next-generation blood pressure remedies, she arheaded an effort to license one from Pont, because she knew this would be aster way into the market than starting m scratch. That drug, Cozaar, and a low-up are still among Merck's biggest ccesses, bringing in \$3 billion a year.

An ability to argue her case in a "retlessly logical and wonderfully intense y," as ex-boss David Anstice puts it, ped McGlynn rise rapidly. She worked consumer marketing, managed care, 1 business development. She held top sts in U.S. marketing during the time erck came under fire and then withew Vioxx. But most of the juries that ve heard cases against the company ve ruled in favor of Merck, and McGlynn has emerged unscathed.

McGlynn's powers of suasion have also helped achieve results on Capi-Hill. Last summer, after erck won approval to mar-a vaccine for shingles—a nful disease that strikes elderly—she started ocking on doors all over pitol Hill. Turned out at the new Medicare Part drug plan prevented docs from getting fully paid administer vaccines. "I olained to [policymakers] at shingles is a debilitating illness that ases a major impact on quality of life," e says. They seem to have listened: On c. 9, Congress passed a bill that fixes the Medicare payment shortfall, which the President signed on Dec. 20.

Leading Merck's charge into the world of vaccines with the likes of Gardasil presents McGlynn with a new set of challenges. She has

PHARMA FAMILY



Margaret G. McGlynn

Once a Merck intern, she's now a power in the drug industry

BORN Sept. 16, 1959, in Buffalo

EDUCATION State University of New York at Buffalo: BS, pharmacy, 1982; MBA, 1983

INSPIRATION Her father (above), a neighborhood pharmacist in Buffalo. She spent snow days shoveling the sidewalk at his store and delivering drugs to patients

FIRST MERCK HIT As a

pharmaceutical product manager in the late 1980s, she guided the heart drug Vasotec toward becoming Merck's first \$1 billion product

FAMILY Married, two children

HOW SHE UNWINDS Sailing, skiing, tennis, and squash

Gardasil could be worth \$4 billion a year, if states require it

spent most of her career working on traditional pharmaceuticals, where success hinged almost entirely on the strength of Merck's marketing muscle. Vaccines, on the other hand, are heavily influenced by a range of powerful organizations, including the Centers for Disease Control and the American Academy of Pediatrics, which issue guidelines for physicians.

In Gardasil's case, Merck has been lobbying state legislators to mandate the vaccine for all young girls. The idea at first generated resistance from some conservative groups, who feared it would sanction promiscuous behavior, since HPV is sexually transmitted. McGlynn sent members of her team out to talk to the groups: "We meet with anyone, whether they share our viewpoint or not."

A PEOPLE PERSON

IN THE END, McGlynn's skill at navigating political mazes could make the difference between a success and a multi-billion-dollar blockbuster. Kris Jenner, a health-care portfolio manager at T. Rowe Price Group

Inc., estimates Gardasil sales will peak at \$2 billion a year, but could go as high as \$4 billion if the states require it. Four states are weighing laws to mandate Gardasil.

A talent for marketing and connecting with customers was apparent back in McGlynn's teenage years, when she clerked at her father's community pharmacy. "She got to know all the personalities," says her brother Ed Hempling. "It was like Mayberry." Her admiration for her father's role as neighborhood medical expert led her to follow in his footsteps. Hempling describes her as "one of those kids with a 10-year plan."

A likely item in McGlynn's plan: fending off GlaxoSmithKline, which could launch an HPV vaccine in 2007. Glaxo's record of fierce price competition has some analysts worried that Merck might have to slash Gardasil's \$360 price tag. To expand the potential market, Merck is testing it in older women and in men, who can be carriers. Taking a page from her Vasotec playbook, McGlynn plans to promote Gardasil's prime advantage: It protects against four HPV strains, whereas Glaxo's drug guards against only two. "That's a fair price for offering the broadest possible public health benefit," she says. Spoken like a real believer. ■



BARREL HOUSE
Véronique,
Philippe,
Laurent,
Robert, and
Frédéric
Drouhin

A Fine Nose for The Family Business

The fourth generation of Drouhin vintners is as devoted to its Burgundies as was the first

BY ERIC SCHINE

YOU'D THINK FAMILY succession would be a nonissue in the rolling vineyards and medieval villages of Burgundy, where some of France's most renowned wines are made. But a fast-globalizing wine industry, combined with laws that make it difficult for local vineyards to expand, have forced many of the region's major players to sell to outsiders in recent years.

One that weathered the storm is Beaune-based Maison Joseph Drouhin, which, despite a financial crisis in the early 1990s followed by a decade under outside owners, is a study in family cohesion. Founded in 1880, the fourth-generation vineyard has grown into one of

Burgundy's largest and most prestigious winemakers. The founder's grandson, Robert, 73, has been stepping aside to put all four of his children into key posts. "Tradition, education, and sustaining the family enterprise are to me the most important values," says Drouhin.

That may sound conservative, but Drouhin's faith that his children would one day inherit and operate the winery has made it one of the most innovative in the region. The business has grown in such a way that each sibling has been able to pursue his or her own area of expertise. In 1987, Drouhin spent \$8 million to develop a 166-acre vineyard in Oregon, and two years later his only daughter, Véronique, began building her career there as a wine-

maker. Now 44, Véronique runs the egon operation. In 1988, wanting to be promote his own wine and other burgundies, Drouhin bought his U.S. distributor Dreyfus, Ashby & Co., eventually putting his son Laurent, 40, in charge of sales. The oldest son, Philippe, 45, turned down his dad's offer to oversee the business in Burgundy, preferring instead to tend the vines. The CEO post is held by youngest brother Frédéric, 38. The combined generations have grown to 116 employees and annual sales of about \$37 million.

Robert Drouhin wasted no time in introducing his children into the business. Véronique got her first taste as a newb when her parents celebrated her birthday by opening a famous 1856 Musigny and placing a drop on her tiny tongue. The four kids grew up, home life, work, and history intermingled. A network of 13th century cellars built by Benedictine monks stretches beneath the family house, the Drouhin offices, and the streets of Beaune. There the Drouhin clan played hide-and-seek and raced around with their schoolmates on roller skates. As they got older, dinner conversation inevitably turned to wine. There were lessons, and, they recall, sometimes very dull discussions comparing, say, the disappointing vintage of 1976 with that of 1977. Wine tasting was a daily ritual from age of 14. "Our father would go around

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ably turned to wine. There were lessons, and, they recall, sometimes very dull discussions comparing, say, the disappointing vintage of 1976 with that of 1977. Wine tasting was a daily ritual from age of 14. "Our father would go around



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the table," says Frédéric. "He would ask, 'Is this a Côte de Beaune or a Côte de Nuits?' Then he'd ask each of us to describe what we tasted."

GOING ORGANIC

AS THE DROUHIN children learned the family traditions, the world was changing. Competition grew as large vineyards in Bordeaux, California, Chile, and elsewhere began producing high volumes of inexpensive, high-quality wines. Yet even as Burgundies were falling out of favor, the Drouhins worked to resurrect Burgundy's mystique. Philippe adopted organic methods of viticulture. Owning its distribution company gave the family a powerful tool for marketing their vision of *terroir*—a wine's connection to the land it's grown on. And the Oregon vineyard gave them room to grow beyond the cramped confines of Burgundy.

Initially, however, the expansion backfired. A global recession and changing consumer tastes had the banks at the Drouhins' door by the early 1990s. The only way out was for the family to sell a 51% stake to Snow Brand Milk Products Ltd., a Japanese beverage conglomerate. "It was a sad time for the family, but we learned a lot about financial discipline," says Laurent.

By 2004, the Drouhins' emphasis on *terroir* was paying off. The family was able to buy back control, and today it owns a 66% stake. The business works something like this: draw in younger wine drinkers with inexpensive bottles, educate them to the earthy and complex pleasures of Burgundy, then introduce them to pricier, high-margin bottles. Drouhin's offerings range from a \$12 bottle of pinot noir to a \$350 Montrachet Marquis de Laguiche. One of its best sellers is Véro, a \$20 blend of Burgundies designed specifically for the U.S. market. "They've done a great job making Burgundy accessible to American tastes," says David DeBenedictis, a wine consultant and vineyard tour operator based in Boca Raton, Fla.

To get the message across, Laurent, based in New York, crisscrosses the U.S. holding wine-tasting dinners for the trade and collectors. He also spends a lot of time making sure Drouhin stays represented on the wine lists of such restaurants as Le Bernardin and The Four Seasons in New York. He sees the family as selling not just wine but Burgundy itself: "We are in the *terroir* business," he says. With wine drinking ever more popular and the ranks of the global affluent swelling, that's not a bad place to be. ■

Is Your Medicine The Real Deal?

Accusations are flying that some pharmacies substitute inferior versions of drugs

BY ARLENE WEINTRAUB

WHEN LESLIE-ANN Lescarbeau saw the sales pitch from a pharmacy called Med4Home on the Internet and TV in 2004, she couldn't resist signing up. Med4Home promised to deliver her medications right to her door and file her Medicare claims for her. Lescarbeau, 50, suffers from asthma and other lung problems and sometimes uses a wheelchair. But what Med4Home actually sent her, she believes, were reformulated versions of the brand-name medicines she was supposed to take. One of the drugs even allegedly contained alcohol, a known lung irritant. After Lescarbeau made several harrowing trips to the ER, struggling to breathe, a doctor discovered the Med4Home drugs and ordered her to switch pharmacies. "I did not see

anything on Med4Home's Web site," said I wouldn't be getting the real thing," says Lescarbeau, a nondenominational Christian pastor who lives in Middletown, Conn.

Now Med4Home's parent company, home health-care provider Lincare Holdings Inc., is in the crosshairs of the Food & Drug Administration. In August, the agency sent a warning letter to another Lincare affiliate that makes the drugs Med4Home delivers. The FDA blasted the affiliate, Reliant Pharmacy Services, making drugs at "ineffective or dangerous dosage levels," maintaining poor quality control practices, and in some cases sending patients non-FDA-approved copies of commercially available drugs without getting clearance from their physicians. The letter, obtained by *BusinessWeek* under the Freedom of Information Act, warns that if the company continues these practices, the FDA "may take immediate enforcement action, including seizure and injunction, against [the company] its products, and its principal officers." A spokesman for Lincare reportedly declined to comment.

Pharmacies are allowed to make and sell their own drugs. The practice, known as compounding, has long been accepted as a way for physicians to tailor drug therapies to individual patients—say, by instructing a pharmacist to turn pills into liquids for someone who has trouble swallowing. Such products can be sold without FDA approval, provided the pharmacy has a prescription from a doctor. But once a compounding pharmacy starts mass-marketing its own recipes, via the Web or other means, the FDA can regulate it as if the pharmacy were a commercial drug manufacturer.

Pressure Points

Compounding pharmacies, which make their own versions of commercially available drugs, are feeling stress:

THE CENTERS FOR MEDICAID & MEDICARE SERVICES will slash payments for compounded asthma drugs to discourage companies from substituting them for FDA-approved products.

THE AMERICAN MEDICAL ASSN. in November called for testing of compounded hormones and for improved reporting of adverse effects.

SENATOR CHUCK GRASSLEY, a Republican, is investigating compounders, while Senator Edward Kennedy and Representative Henry Waxman, both Democrats, have discussed taking action.



DOSE CALLS
Lescarbeau blames
Med4Home for
increased ER visits

The FDA and professional organizations are starting to take action against compounding pharmacies, with targets ranging from mom-and-pop operations to publicly held companies such as Lincare. And while other types of compounded drugs have raised alarm bells, the FDA lately has focused on respiratory medications. The same day the agency issued the warning to Lincare's subsidiary, it also warned Rotech Healthcare and 3M Medical to stop mass-producing unapproved respiratory drugs.

"We think the compounding of inhalation drugs is dangerous and requires vigorous attention," says Steven Sander, head of the office of compliance at the FDA's Center for Drug Evaluation and Research.

Some compounding pharmacies use sneaky tactics to get patients to switch from

FDA-approved drugs to their own concoctions, critics contend. They target seniors who respond to ads or who order medical equipment, seeking permission to switch them to "generic" or "low-cost" versions of the drugs their doctors have prescribed even when no FDA-approved generics exist. A Med4Home TV ad that ran in 2005 included a disclaimer that its products and services had not been "authorized" by the Health & Human Services Dept., but it flashed by so quickly that the average viewer probably wouldn't have had time to read it. No such disclaimer is readily visible on Med4Home's or Lincare's Web sites.

The FDA is beginning to crack down, focusing on respiratory drugs

"Patients simply want to breathe," says Nancy Sander, founder of Allergy & Asthma Network Mothers of Asthmatics (AANMA), a patient advocacy group in Fairfax, Va.

"They don't know to ask, 'Is this an FDA-approved drug?'" AANMA, which receives some funding from pharmaceutical companies, has documented more than 20 cases of patients who believe they have been harmed by non-FDA-approved respiratory drugs. In the summer the group presented the details to lawmakers on Capitol Hill, including Senators Edward Kennedy (D-Mass.) and Chuck Grassley (R-Iowa).

Some doctors may be getting duped, too. Compounders sometimes gain doctors' permission to switch patients to unapproved drugs by faxing them authorization forms and pressing them for their signatures. "I don't know how many of these passed my desk, but I'm sure I signed them," admits Dr. Allan Stillerman, an allergy specialist in the Minneapolis area. Stillerman, who has served as a paid speaker for several pharmaceutical companies, became more vigilant several months ago after he discovered three of his patients were on compounded drugs that he didn't remember prescribing. "The fact that I found three [patients] in my practice makes me wonder: How much more rampant is this problem?"

ADVERTISING UNDER ATTACK

WITH THE FDA strapped for resources, some big companies are stepping in to track down wayward compounders. In 2005, AstraZeneca sued online pharmacy Broncho-Dose Ltd. for false advertising, alleging that its Web site was improperly pitching a compounded version of Astra's Pulmicort Respules, an asthma drug that patients inhale through a device called a nebulizer. Broncho-Dose didn't admit to any wrongdoing. But, as part of a settlement, it had to place a disclosure on its site that says it does not sell Pulmicort Respules and that the compounded version has not been proven to have the same effect as the real drug. One problem: On the Spanish version of the site, the disclaimer is in English. When told of this situation by *BusinessWeek*, AstraZeneca said it would look into having the warning translated. "We'd like for people to understand it," says Cathy Bonuccelli, vice-president for external scientific affairs. Broncho-Dose declined to comment.

In November, Lescarbeau, the Connecticut pastor, called Med4Home out of sheer curiosity and asked if it sells Pulmicort. "They said they have a substitute," Lescarbeau recalls, frustration rising in her voice. "No, no, no!" she adds. "There is no substitute." ■

Going to the Head Of the Class

How the PhD Project is helping boost the number of minority professors in B-schools

BY JANE PORTER

WHEN MIRIAM Stamps earned a PhD in marketing from Syracuse University in 1982, there were no black professors at the business school. And she was the only African American in her class. "We were few and far between," says Stamps. "And we were isolated."

A quarter century later, minority doctoral students remain rare on B-school campuses. And only about 3% of all business professors are African American, Hispanic, or Native American, according to the Association to Advance Collegiate Schools of Business (AACSB).

But increasing numbers of minorities are forsaking a big corporate paycheck for the intellectual rigors of academia. This year the percentage of minorities enrolled in business PhD programs is double that of minorities on B-school faculties, a sign that future faculties will include more minority professors. It's already happening at Syracuse's Whitman School of Management, where minorities account for 8 out of 73 faculty members—including the dean, Melvin Stith, who is African American. As for Stamps, she now runs the marketing department at the University of South Florida's business school in Tampa.

CHERRY-PICKING PROFS

AT A TIME WHEN SCHOOLS have been downplaying affirmative action, many deans have looked to the PhD Project, a nonprofit that encourages minority business professionals to earn PhDs and go on to become professors. The organization was launched in 1994 by Bernard J. Milano, a former KPMG partner who runs the KPMG Foundation, a group dedicated to supporting business educa-



tion. Milano was frustrated that schools weren't producing enough minority business grads. Before the PhD project, there was a lot of talk about boosting diversity on campus but little action. Schools essentially went around cherry-picking minority professors from one another. Now, says Stith, "we're increasing the size of the pie."

Milano, who runs the PhD Project, says the basic strategy is to target professionals hungry for intellectual stimulation. Tonya Williams, who completes her doctorate in marketing at Northwestern this spring, is a typical recruit. A former general manager at the Atlanta-based software

company S1 Corp., Williams gave up challenge of managing hundreds of employees, sold her house, and traded power suits for jeans and a yearly stipend of less than \$30,000. It was a major cut, but she's not complaining. "The nobody looking for me in my office at the morning, and no one looking for at 7 p.m.," she says. Williams will join B-school faculty at the University of Notre Dame this summer.

For recruits like Williams, the PhD Project seeks to demystify the process of becoming a professor. Candidates are educated on tenure, research, and working strategies. They quickly learn

that because business professors are in such high demand these days, they can earn to \$160,000 a year—a decent middle management salary. It's this "information intervention," says Milano, that has allowed the program to play a role in the near tripling of minority faculty in B-schools over the past dozen years, from 294 to 833.

Getting students enrolled is half the battle. Having them complete the program is the prize. To help make that happen, the PhD Project has a network of student support groups. Andre J. Holmes, a fourth-year PhD accounting student at Florida State University, says the program is invaluable. When his father died during his first year, his peers were there for him. Without their support, Holmes, he's not sure he would have made it. According to the PhD Project, 90% of minority PhD students succeed vs. an estimated 50% of all business PhD students. What's more, 99% of minority doctorate holders go on to teach, Milano adds.

HOLMES The PhD Project says 99% of minority doctorate holders go on to teach.

More minority professors arguably lead to a more diverse student population. There's plenty of room for improvement. *BusinessWeek's* Top 30 B-schools, by minority enrollment, excluding Asian Americans, ranges from 16% to as low as 6%. B-school deans are betting that students who interact with minority business professors, or even teaching assistants like Holmes, will graduate better prepared for a more diverse business world. ■

I Want My Food Network'

s popularity among young adults is proving a boon for Scripps as the news business weakens

JOSEPH WEBER

LIKE A LOT OF OLD-LINE media companies, E.W. Scripps Co. is having problems. Its 20 newspapers are battling circulation and ad declines as readers and advertisers move to the Web. Which is why the outfit's decision in 2007 to gobble up the Food Network now seems so prescient. Food's performance, along with that of its sister channel, Home & Garden Television, has helped its stock rise 22% since August. Even better, the Food Network is increasingly beloved by that most prized demographic: the 18-to-34 set. Typical of the breed is Graham A. Kates, a 21-year-old political science major at Binghamton University. He and his dozen classmates just can't get enough of the fiery Giada DeLaurentiis, the *Everyday Italian* host, whose revealing outfits have helped win her a devoted following on college campuses around the country. "It's not the cooking appeal," says Kates, "so much as it's her appeal." He and his friends record the show regularly so little things like classes don't get in the way. Needless to say, Scripps is loving the attention from younger viewers. Attracting a younger audience is crucial given the graying of Food's core audience of upscale women aged 35 to 54. Still, like any media company looking for a younger audience, the cable channel, which boasts 90 million subscribers, is being careful to avoid alienating its longtime viewers. "The Food Network isn't trying to become MTV," says Scripps Networks Executive Vice-President Burton F. Jablin. "That would be a mistake." With the channel now contributing nearly 10% of the cable

TV unit's revenues, Scripps's challenge is finding the right mix of programming for Mom and the kids.

How to account for the younger generation's abiding interest in all things culinary? Putting engaging hosts on the screen is a major part of it. The biggest star in the Food Network kitchen, of course, is Rachael Ray. Oh sure, the indefatigable Ray may seem a tad overex-

posed. But her anti-Martha approach—quick meals that anyone can prepare—appeals not just to time-pressed parents but also to kids who might be intimidated by the perfectionism of you-know-who.

'KINDA GROSS'

YOUNG GIRLS seem to be cooking more than the previous generation did. Trendspotters say the organic craze, as well as all the talk about an obesity epidemic, is prompting many youngsters to take responsibility for eating better. "They're making decisions in grocery stores," says Laura Caraccioli-Davis, who runs the entertainment marketing division at Starcom, a Chicago media-buying firm. "There's a lot of talk about health and wellness among kids." College guys, meanwhile, scan cooking shows to pick up tips to impress dates. "Any time a girl sees guys cooking something delicious," says Kates, "it definitely helps out."

Then there's Kelsey Brown. The Knoxville (Tenn.) eighth grader loves to see how the likes of candy, pizza, and hot dogs are made on the more-than-you-really-need-to-know show *Unwrapped*. "Sometimes it's kinda gross," says Kelsey. "One time I was watching a show on, like, Cheetos or chips, and I was, like, 'Ooh, I'm not sure I like that.'"

Although Scripps isn't remaking the Food Network for a younger audience, it is letting advertisers know that teens and twentysomethings are avid viewers. "Having the younger end makes sure we stay young," says Brooke Bailey Johnson, whose own kids assured her Food was cool when she became its president in 2004. She has won over such youth-

oriented advertisers as McDonald's, Michelob, and Monster Worldwide. And Sony Pictures and Paramount hawk such fare as *Talladega Nights* and *Elizabethtown* on Food, which now is talking with DreamWorks Animation, Warner Bros., and Disney about 2007 releases targeting the younger demo.

Yes, the bet on the Food Network looks plenty savvy—especially if HGTV suffers amid the housing slump. In the first nine months of '06, Scripps's newspaper operating revenues dropped 0.1%, to \$536.3 million. Without the TV properties, which helped boost overall revenues by 18%, to \$1.8 billion, the 129-year-old company would be a less nourishing investment. ■



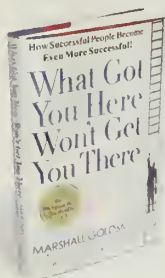
DISH TV Giada DeLaurentiis is a cult favorite among college men



GOLDSMITH
The author tells executives some home truths

Now Go Out and Lead!

*In his new book, **What Got You Here Won't Get You There**, executive coach Marshall Goldsmith writes about being a better leader. Here are two tips for starters.*



AT THE NEW YEAR, we all make resolutions. We'll shed those extra pounds, spend more time with the family, lower our handicap, call our Mom more often, read *War and Peace*. The list of resolutions is as endless as the imperfections we see in the mirror. We ask ourselves: How can we be better, more successful? Funny thing is, in striving to be better human beings, we rarely resolve to do better in our interpersonal relationships—at least not in any specific way to stop doing things that annoy other people. And yet, in almost two decades as an executive coach, I've learned that changing one or two interpersonal habits can have a make-or-break impact on someone's ability to lead, and to get ahead. My book identifies 20 habits that rub people the wrong way and tells how to break them. Here are two:

ANNOYING HABIT NO. 1: CLINGING TO THE PAST

THERE IS A SCHOOL of thought among psychologists that we can understand our errant behavior by delving into our past, particularly our family dynamics. This school believes "when it's hysterical, it's historical." If you're a perfectionist, it's be-

cause your parents never said you were good enough. If you operate above the rules, it's because your parents doted on you and inflated your importance. If you freeze around authority figures, it's because you had a controlling mother. And so on.

I refuse to attend any school that clings to the past—because going backward is not about creating change. It's about understanding. One of my earliest clients spent hours telling me these issues. Let me explain my mother and father." It was a long unendurable whine. Finally, I reached into my pocket for a coin and said, "Here's a quarter. Call someone who cares about you."

Don't get me wrong. There's nothing wrong with understanding. Understanding the past is perfectly admissible. Your issue is accepting the past. But if your issue is changing the future, understanding won't take you there. My experience tells me that the only effective approach is looking people in the eye and saying, "If you want to change, do this."

It takes me a long time to convince clients that they can change the past, or make excuses for it. All they can do is accept it and move on. But for some reason, many people are living in the past, especially if going back there lets them blame someone else for anything that's gone wrong in their lives. That's when clinging to the past becomes an interpersonal problem. We use the past as a weapon against others.

I learned this from my daughter Kelly. She was 7 years old. We were living in a nice house in San Diego (still my home). One day, annoyed over a professional setback, I came home and took out my annoyance on Kelly. I trotted out the speech that begins, "When I was your age..."

started yammering about growing up in Kentucky and how didn't have money and how hard I had to work to become first person in my family to graduate from college. Contrast this, of course, with all the wonderful things Kelly had. She ended my diatribe, instinctively letting me vent. When I was shed, she said: "Daddy, it's not my fault you make money." That stopped me in my tracks. She was right. How could I expect her to know what it's like to be poor—when I was damn sure she never would be? I chose to work hard and make money. She didn't. In effect, I was bragging about how clever I was for having triumphed over adversity—and masking that boasting by dumping my frustrations on her. She called me on it. Stop blaming others for the choices you made.

NOYING HABIT NO. 2: REFUSING TO EXPRESS REGRET

EXPRESSING REGRET, OR apologizing, is a cleansing ritual, like confession at church. You say "I'm sorry"—and feel better. It's the theory at least. But it's hard for many of us to do.

We think apologizing means we have lost a contest. It feels humiliating to seek forgiveness, because we think it suggests servile. We believe that apologizing forces us to cede power when, in reality, it's a great control tactic.

Whatever the reasons, refusing to apologize causes as much ill will in the workplace, and at home, as any other interpersonal flaw. Just think how bitter you have felt when a friend ended to apologize for hurting you or letting you down—and think of how long that bitterness festered.

If you look back at the tattered relationships in your life, I suspect many began to fray at the moment when one person couldn't summon the emotional intelligence to say: "I'm sorry." People who can't apologize at work may as well be wearing a T-shirt that says: "I don't care about you."

The irony, of course, is that apologizing turns adversaries into allies, even servants. It is one of the most powerful and resonant gestures in the human arsenal—almost as powerful as a declaration of love. If love means, "I care about you, and I'm happy about it," then an apology means, "I hurt you, and I'm sorry about it." It compels people to move forward into something new and, perhaps, wonderful together.

The best thing about apologizing is that it forces everyone to go on of the past. In effect, you are saying: "I can't change the past. All I can say is I'm sorry for what I did wrong. I'm sorry I hurt you. There's no excuse and I will try to do better in the future." That's tough for even the most cold-hearted to resist.

My client Beth was the highest-ranking woman at a Fortune 100 company. Her bosses loved her. So did her direct reports. By contrast, she was loathed by some of her peers. When I surveyed her co-workers I learned that she had a particularly toxic relationship with a hard-boiled division chief named Harvey. (Both of these names have been changed.) Beth was a smart, know-it-all young hotshot brought in by the CEO to stir things up. Harvey, however, saw her as arrogant and felt she didn't respect the company's history and traditions. The two were in a perpetual turf war, and it brought out the worst side of her personality: a mean, vindictive streak. We agreed that this was a fault we had to fix.

The first thing I made Beth do was apologize—to Harvey. I could see her bristle at the suggestion, but argued that she had to do this to improve the situation. The thought of yielding to Harvey was so distasteful to her that I actually scripted the apology. I didn't want misgivings to creep in and pollute the apology, which would destroy the effect. To Beth's credit, she followed the script. She said: "You know, Harvey, I've got a lot of feedback here, and the first thing I want to say is that I'm positive about a lot of it. The next thing I want to say is that there are some things at which I want to be better. I've been disrespectful to you, the company, and its traditions. Please accept my apologies. There is no excuse for this behavior and..."

Harvey cut her off. She looked at him with alarm, poised for another fight, until she noticed tears in his eyes. "Beth, it's not just you," he said. "It's me. I have not been a gentleman in the way I've treated you. I know that it was hard for you to tell me these things, and they are not all your problems. This is my problem, too. We can get better together."

That's the magic in this process. When you declare your dependence on others, they usually agree to help you. And in the course of making you a better person, they inevitably try to become better people themselves. This is how individuals change, teams improve, and companies become world-beaters.

If you want to become even more successful in 2007, start by letting go of the past and learning to say: "I'm sorry." ■

Excerpted from What Got You Here Won't Get You There, by Marshall Goldsmith and Mark Reiter, to be published Jan. 9 by Hyperion Books.

BusinessWeek.com For all 20 tips, plus more from Goldsmith's book, go to www.businessweek.com/extras.

PLAYBOOK: BEST-PRACTICE IDEAS

Enough is Enough

When people reach a certain level of success, they are less likely to face laws of skill, intelligence, or personality. What hinders them are weaknesses in leadership behavior. Here are some common ones:

1. WINNING TOO MUCH

The need to win at all costs and in all situations.

2. ADDING TOO MUCH VALUE

The overwhelming desire to add our two cents to every discussion.

3. PASSING JUDGMENT

The need to rate others and impose our standards on them.

4. MAKING DESTRUCTIVE COMMENTS

The needless sarcasms and cutting remarks that we think make us sound sharp and witty.

5. STARTING WITH "NO," "BUT," OR "HOWEVER"

The overuse of these qualifiers which secretly say to everyone, "I'm right. You're wrong."

6. TELLING THE WORLD HOW SMART WE ARE

The need to show people we're smarter than they think we are.

7. SPEAKING WHEN ANGRY

Using emotional volatility as a management tool.

8. NEGATIVITY

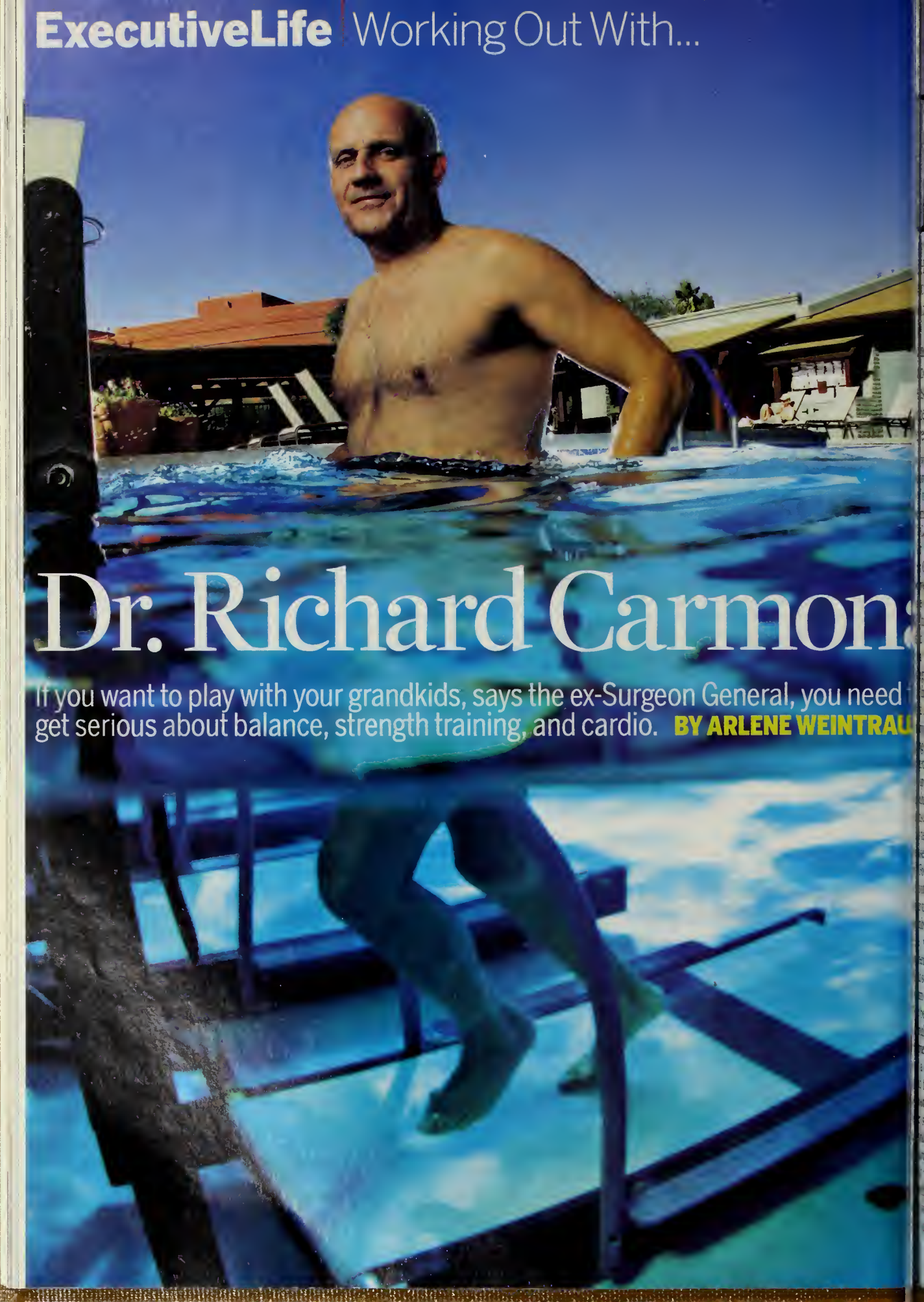
The need to share our negative thoughts.

9. WITHHOLDING INFORMATION

The refusal to share information in order to maintain an advantage over others.

10. FAILING TO GIVE PROPER RECOGNITION

The inability to praise and reward.

A full-page photograph of a middle-aged man with a shaved head and a slight smile, standing in a swimming pool. He is using a water treadmill, which is a large, dark-colored mechanical device with a flat surface and side rails. The water is splashing around his waist. In the background, there are lounge chairs, a building with a red roof, and a clear blue sky. The overall scene is bright and sunny, suggesting a resort or a well-maintained pool area.

ExecutiveLife Working Out With...

Dr. Richard Carmona

If you want to play with your grandkids, says the ex-Surgeon General, you need to get serious about balance, strength training, and cardio. **BY ARLENE WEINTRAUB**

DURING A FOUR-year term as U.S. Surgeon General, Dr. Richard Carmona was always greeted the same way by President George W. Bush. He'd say, "Did you get your workout in today?" recalls Carmona, who served from 2002 to 2006. Carmona's pet platform is disease prevention, and since exercising is one of the best ways to ward off illness, he knew he had to practice what he preached. So at least five days

each week, sometimes very early in the morning or late at night, he would dash to one of the military bases near his home in Bethesda, Md., to work out. Carmona, 57, still preaches prevention, and his current pulpit is the upscale spa operation at Canyon Ranch in Tucson, where he serves as vice-chairman and chief executive of the health division. He spends part of his time reviewing the latest health science research to make sure the spa incorporates best practices into its programs. He also teaches public health at the University of Arizona in Tucson and serves as president of the nonprofit Canyon Ranch Institute. And he's planning the first symposium that will bring together six Surgeons General. "We'd like to apply our experience to improving the health, security, and safety of all Americans," says Carmona, who spent much of his term trying to influence public policy on secondhand smoke and obesity.

For Carmona, staying fit has been a necessity throughout a career that at times has resembled a superhero's. He was a decorated war hero, serving in Vietnam and on the SWAT team in Tucson, where he became famous for pulling out of a helicopter (to save a victim from a helicopter crash) and for engaging in a shoot-out with a murder suspect. Today his workout involves both cardiovascular routine and weight training, a combination designed to ward off the ravages of aging, such as heart



STRENGTH AND ENDURANCE

A physician-approved routine might include (clockwise) balance and weight training, back extensions, and leg lifts. See table below for details.

disease, while strengthening key muscles used for everyday tasks.

Carmona begins with a half-hour of cardio, often on a stationary bike. "It warms up the whole body," he says. Then he moves on to the strengthening part of the routine. Although he does plenty of leg and arm lifts, he says it's especially important to focus on "the core"—the muscles in

the abs and back. Many of his exercises combine core strengthening with other muscle movements. For example, he stands on a ball, which forces him to use core muscles to maintain balance, while he works his arms and upper back by pulling cables attached to 60 pounds of weights. "If you want to stay active and play with your grandkids, these are things you need to do," he says.

Carmona finishes with another round of cardio, often on an underwater treadmill in the spa's pool. The machine, which runs on hydraulic power, offers the same cardiovascular benefits as a land-based treadmill, but it doesn't pound the joints. "It's great for people who love to run but have knee, hip, and back injuries. It's like running on the moon," says Carmona, who has endured eight knee surgeries. You can buy an underwater treadmill like those at Canyon Ranch from Ferno Performance Pools for \$12,000 to \$16,000.

For anyone who finds his workout too punishing, Carmona notes it can easily be scaled down and tailored to individual goals. Consult your doctor, he says, to design a safe routine. What's most important, he insists, is to do something. "Carve out that hour—you can do it."

BusinessWeek .com

To see more of Dr. Carmona's workout routine, go to www.businessweek.com/extras.

Carmona recommends performing exercises like these in two sets of 8 to 10 repetitions sandwiched between cardiovascular workouts of 20 minutes each

1 WARM UP Use a stationary bike or elliptical machine

2 LATERAL PULL-DOWN Sit on the bench and pull the bar down to your chest, lifting a weight that's challenging but not taxing

3 BENCH PRESS Lie on the bench and lift weight up from the chest

4 STRENGTHEN WHILE BALANCING Stand on air-

filled balance ball while simultaneously lifting weights on pulleys

5 LEG LIFTS Hanging on a bar, lift legs to the middle and to each side

6 BACK EXTENSIONS Sit stomach-down on a Roman chair, hold a weight, bend forward and back up

7 SEATED LEG PRESS Sit on the leg press machine, rest

your feet under the bar, and straighten your legs to lift the weight

8 CRUNCHES Lie on a mat or use a machine to do partial sit-ups, using ab muscles

9 FINISH Swim laps or run on an underwater treadmill





BY JONATHAN SCHWARTZ

We Left Our Hearts With Tony Bennett



A CITIZEN OF MUSIC turned 80 several months ago. He was celebrated with unusual affection, and a TV show in honor of a new album (*Duets: An American Classic*) drew rave reviews. He appeared everywhere, it seems, to be interviewed and extolled. During Christmas, you'd hear his voice in delis and pizzerias, in Saks Fifth Avenue, and, I'd guess, in any holiday-spirited concern and in homes all over the world. Always and everywhere, it is instantly Tony Bennett.

I imagine that unconcocted smile of his, warm and unthreatening, guileless and receptive for the people who shout his name: "Hey, Tony!" I have walked with him in New York, London, Las Vegas, Palm Springs. "Hey, Tony!" There is never an entourage—only Bennett.

I was his guest in Las Vegas in 1978 and had gotten up early. Outside his Sahara Hotel penthouse, I walked over to the railing that overlooked the cloudy town and found that Tony's show the night before had an afterlife—it rang in my head, song after song. I counted 38 titles received by a packed house, and this was a fallow period. Not many records, the music having changed around him, around Frank Sinatra and the rest. What to do with the Bee Gees?

At the railing, I recalled some of Tony's courageous notions:

- First vocalist to make an album primarily with percussion instruments (*The Beat of My Heart*, 1957).

- First male popular star to make an album with just a piano (*Tony Bennett Sings for Two*, 1960).

- First star to invite a jazz icon, in this case pianist Bill Evans, into the recording studio alone (they made two superb albums in 1975 and 1977).

- Second male star (Sinatra was the first) to come roaring back after a period in which little attention was paid.

This amazing resurrection was choreographed by Danny Bennett, one of Tony's two sons. Danny was all rock 'n' roll, but



he helped put his father back on Columbia Records, where Tony had made many hit singles in the 1950s. There followed a cascade of remarkable albums, which account for 13 Grammys, and a wide appreciation from younger generations. It was Danny's idea to install his father in rock venues. And let me tell you, Tony was adored, cheered, cherished.

Back to the Sahara roof in 1978. Tony stood there in a terry-cloth robe and red slippers, and we talked.

"What do you think when you're asked to sing *I Left My Heart in San Francisco*? Isn't it tedious?" I asked.

"You've got to understand," he said. "To be recognized, identified, all over the world, never get tired of it."

"What do you think about when you're singing?" I asked.

Tony smiled. "I sing a song. I go right along, until I come to the word 'love.' That's where I put an emphasis. The word 'love.'"

We stood there for perhaps half an hour. So many years ago.

And now he is 80. His singing is still rich and nuanced. "Tony never sings a song the same way twice," a friend of his told me. I'd like to point out that Tony never sings a song the same way once.

remains inventive and ingenious.

He always overrecorded when making an album. There are 179 unreleased tracks plus an unreleased album with guitar, bass, and sax, called *A Quiet Thing*. We can expect, through the year, to receive new Tony Bennett releases.

Brand new material from a superb elder statesman of music. Isn't that something. ■

Jonathan Schwartz hosts Frank's Place channel on XM Satellite Radio, as well as weekend shows on WNYC-FM, a New York public radio station.



BY ROBERT PARKER

Cuvées That Make the Most of Comfort Food

IN A COLD WINTER'S NIGHT there's nothing more satisfying than simple fare such as a steaming bowl of spaghetti and meatballs or a lasagna, its pockets of sauce still bubbling as the dish comes out of the oven. Whether you're enjoying these comfort foods at a trattoria or at home, here are a few Italian wines that make these dishes even more special. They will please the palate and the purse.

Majo Norante 2005 Sangiovese

91 points. It offers an amazing display of blackberry and black cherry intermixed with al, new saddle leather, and earth notes. And in foudres (extra large barrels), it is a shining example of sangiovese that should drink well for two to three years. \$11

Carraia 2005 Sangiovese IGT

91 points. This wine is aged three months in French oak and bottled early to preserve fruit. Its dense ruby/purple-hued color is accompanied by sweet black cherry and black fruit, forest floor, and spring flower characteristics. Good density, medium body, and a dry, fresh, lively, tangy finish suggest it will be enjoyable for two to three years. \$11

Costa di Mezzano Non-Vintage Prosecco Brut Negligio

91 points. One of the finest widely available sparkling wines in the marketplace, this fresh, lively sparkler, a blend of 95% prosecco and chardonnay, exhibits notions of orange, brioche, and honeyed grapefruit. Light-bodied, effervescent, and packing plenty of zip in its delicate personality, it should be enjoyed within a year of purchasing. \$12

Argiolas 2005 Costamolino di Sardegna

91 points. The delicate straw color of this wine is followed by beautiful aromas of lemon, orange, lemon, honey, apple skin, and a hint of tropical fruits. This crisp, elegant,

medium-bodied, intense white should be enjoyed over the next year. \$14

Argiolas 2005 Costera

91 points. This powerhouse red represents

Sardinia's version of Châteauneuf du Pape. It is composed of 90% cannonau (a local grape believed to be a derivative of grenache) and 5% each of carignano and bovale sardo. It boasts sweet black cherry interwoven with notes of pepper, Provençal herbs, spice box, and licorice as well as superb texture and depth. Drink it over the next two to three years. \$15

Tiefenbrunner 2005 Pinot Bianco dell'Alto Adige

89 points. This white wine displays lovely aromas of flowers, tropical fruits, especially mandarin oranges, buttered lemons, and a hint of pineapple. Delicious, fresh, and medium-bodied, with loads of fruit, crisp acidity, and pronounced aromatics, this is a gorgeous white to enjoy over the next year. \$15

Monti 2005 Montepulciano d'Abruzzo

90 points. Winemaking consultant Riccardo Cotarella has changed this once-burly, almost uncivilized wine to a more sophisticated, pure, polished offering. Monti's dense purple-colored wine (it includes 5% sangiovese) was aged in oak foudres. It offers vivid blackberry, melted licorice, pepper, and herb characteristics along with a full-bodied, powerful, yet pure, supple-textured style. Drink it over the next two to three years. \$18

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.



Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras

Follow the Patents

Looking for hot stocks? Go for companies whose ideas are often cited in other innovations. **BY CHRISTOPHER FARRELL**

THERE'S ALMOST ALWAYS a big payday for shareholders of truly innovative companies. Since the introduction of the iPod in 2001, for instance, Apple Computer stock is up ninefold. For investors, the big challenge is putting a number on a company's creative and intellectual prowess. Corporate accounting is fine for keeping track of inventories but not for valuing ideas. Reports on research and development spending are spotty and make no qualitative judgments.

That's why hedge fund gunslingers, private equity mavens, and other professional money managers are turning to patents for insight. "You want to own a company for the innovation embedded in its patents," says Keith Cardoza, managing director at Ocean Tomo, a Chicago merchant bank specializing in intellectual property.

The U.S. Patent & Trademark Office awards patents on original ideas. Each patent application contains lots of information. Problem is, more than 4 million patents have been issued since 1983, according to Ocean Tomo, and some 4,000 new ones are accepted every week. Obviously, most patents won't pay off. So which ones will?

Scholars have learned that a powerful proxy for innovative expertise is how frequently a company's existing patents are cited in patent applications. Indeed, one-quarter of all patents receive no citations, and a mere 0.01% earn more than 100 citations, according to Bronwyn Hall, an economist at the University of California at Berkeley. In a study by four economists covering seven industries that generate a large number of patents, researchers found that a patent mentioned 14 times by other patents is worth, on average, 100 times as much as a patent cited only 8 times. Another estimated that companies with widely cited patents and a track record of turning

them into products outperformed the market by 1,000% over a 10-year period.

This insight is behind the Pipeline Quality measure created by 1790 Analytics, a consulting firm in Mt. Laurel, N.J. (The name comes from the date the firm was founded.)



ent was issued in the U.S.) The other cal factors that feed into the measure a patent's originality, its applicability ifferent fields, and the growth trend company's patent activity.

ED BATCH

FIRM GENERATED a list of inter- ing prospects for *BusinessWeek* in ember, 2005, and the subsequent lts have been terrific (table)—11 ners, 4 losers, and an average return was more than twice that of the dard & Poor's 500-stock index and e than three times that of the NAS-) Composite. Now it has 15 picks for new year (table).

790 Analytics uses several factors to e up with its choices. Among them ompanies with a high Pipeline Qual- number and a low price-earnings o relative to their industries. Some of names aren't surprising, such as 3M, a, Zygo, and Wyeth. High-tech and rmaceutical companies are tradition- R&D- and patent-intensive.

ut Grant Prideco? Grant is an oil and equipment services company with a ldwide market share of some 50% in pipes. It's the world's third-largest ufacturer of drill bits. The energy nness is inherently cyclical, but the al economy's thirst for energy ap- s unquenchable. The company has ral patents for drill pipes that go very p. They are also resistant to metal fa- e. "These are the kind of technologies eed as oil and gas reserves become ler to get," says Patrick Thomas, a cipal at 1790.

activ is a leader in waste bags and storage products that is best known ts Hefty line. Although earnings have a depressed until recently, largely be- e of higher costs for plastic resin, the any has been able to raise prices, it's known as an innovator in plastic lucts.

r take a look at Magna International,

an auto parts company that is doing relatively well in a seriously troubled industry. The company devotes a sizable portion of its profits to R&D. Also on the list is Polaris Industries, the Minnesota maker of snowmobiles, all-terrain vehicles, and Victory motorcycles. Polaris engineers are among the most admired in the business, according to researchers at Morningstar. "When people think of patents, they often think it will be all pharmaceuticals and high tech," says Thomas. "It isn't."

Not interested in picking stocks? With the growing focus on patents, Claymore Securities launched a patent index exchange-traded fund on Dec. 15. The ETF is based on the Ocean Tomo 300 Patent Index (winnowed from an initial list of 1,000) created by the merchant bank. It's a market-weighted index that covers a broad spectrum of industries. Among its more important valuation metrics is the observation that while a patent lasts for 20 years, a fee has to be paid every four years to maintain it. That the company continues paying the fee is a clue the patent is valuable.

The investment returns on innovative activities are inherently uncertain—it's the nature of the beast. Evaluating patents may not be a surefire way to stock market profits, but it is an intriguing way to gain an edge. ■

Patent Picks of 2006

These companies were highlighted in our 2006 Investment Outlook. Overall, they returned 26.1%, compared with 12.6% for the S&P 500 and 7.1% for the NASDAQ (Dec. 1, 2005, through Dec. 20, 2006)

COMPANY / SYMBOL	PRICE CHG.
Garmin GRMN	108.1%
BellSouth BLS	63.6
Inter. Game Tech. IGT	55.6
Cisco Systems CSCO	54.8
Deere DE	40.5
Novellus Systems NVLS	35.9
Applera ABI	33.3
Lam Research LRCX	29.1
Weatherford Inter. WFT	20.7
Microsoft MSFT	7.9
Lyondell Chemical LYO	2.5
KLA-Tencor KLAC	-6.5
SanDisk SNDK	-12.5
Amgen AMGN	-14.9
Sprint Nextel S	-25.0

These companies had an above-average Pipeline Quality score plus a p-e ratio below 30 and also below their industry average (where available)
Data: 1790 Analytics, *BusinessWeek*

Inventive Stocks for 2007

COMPANY	P-E RATIO*	PIPELINE QUALITY**	INDUSTRY
Grant Prideco GRP	13.9	3.52	Oil & gas equipment, services
Polaris Industries PII	16.1	3.06	Recreational vehicles
MicroStrategy MSTR	24.1	2.97	Business software
Donaldson DCI	21.9	2.72	Pollution & treatment controls
Amkor Technology AMKR	11.0	2.44	Semiconductor
Albany International AIN	15.7	2.40	Textile industrial
Pactiv PTV	20.0	2.32	Packaging & containers
Magna International MGA	15.9	2.07	Auto parts
Intermec IN	21.4	2.01	Computer peripherals
3M MMM	17.2	1.95	Conglomerate
Palm PALM	4.4	1.95	Computer systems
Wyeth WYE	17.2	1.94	Pharmaceuticals
Zygo ZIGO	19.0	1.61	Scientific instruments
Newport NEWP	27.4	1.60	Scientific instruments
Cummins CMI	8.7	1.59	Diversified machinery

*Trailing 12 months as of Dec. 20, 2006 **Pipeline Quality measures the impact, originality, and generality of a company's patent portfolio. The average Pipeline Quality value for the whole patent system is 1. A number above that reflects above-average patent performance. A figure below 1 is sub-par
Data: 1790 Analytics, *BusinessWeek*



Home Loan Homework

Here's a cheat sheet for those looking to borrow. **BY MARA DER HOVANESIAN**

PERHAPS YOU'VE BEEN thinking about buying a new house, but have been waiting for prices in your area and interest rates to come down. While you can never predict the bottom, prices in many real estate markets look like they're leveling out. Better yet, the Federal Reserve is expected to cut interest rates this year, which will help spur sales and a new round of refinancings.

So it's a good time to review some mortgage basics—no matter if you've been around the block before. "Even the most sophisticated borrowers need to ask a lot of questions," says Bruce Hiatt, owner of Luxury Realty Group in Las Vegas. "It's easy to make assumptions, and often those assumptions are incorrect."

KNOW YOUR LONG-TERM GOALS

IF YOU'LL STAY PUT in the house for as far as the eye can see, a 30-year, fixed-rate mortgage protects you from interest rate fluctuations. Your rate will be higher than with an adjustable rate loan, but your monthly payment will be locked in.

Many recent borrowers who didn't understand adjustable-rate mortgages, with their low teaser rates and payment resets, are still struggling after two years of rates adjusting upward. If in the next few years you either plan to sell the home or expect a pickup in income that will cover higher monthly payments, you should consider a lower-than-market rate at the start. Rick Soukoulis, CEO of LoanCity in San Jose, Calif., a wholesale mortgage banker, says borrowers should insist that the broker calculate the entire cost of all mortgage options, including fees and interest, in various interest rate scenarios.



SHOP THE WEB

THE NET IS a great tool for boning up on mortgage terms and rates. It's also a vibrant marketplace where brokers and Realtors are competing for your business. "Everything is negotiable," says Marc Diana, CEO of Los Angeles-based Leadpoint.com, an online marketplace for mortgages that fields inquiries for Web sites, such as mortgagerate.com and shoplowestrates.com. "The market for mortgages is competitive, so consumers should use it to their advantage." Diana warns that some sites match borrowers with multiple lenders, inundating them with lots of pesky phone calls and few quality offers. Before putting your mortgage out to bid, ask how many lenders will respond. You decide how many calls you're willing to take to get the best deal.

DO THE MATH BEFORE PAYING POINTS

PEOPLE PAY POINTS up front (one point equals 1% of the principal) to lower the interest rate. But a new study finds that home buyers often end up paying more than they would have with no points and a higher rate. After analyzing 3,785 mortgages orig-



inated from 1996 to 2003, Abdullah Y. of Penn State's Smeal College of Business and Yan Chang, an economist at Freddie Mac, found that fewer than 1.5% of borrowers held loans long enough to make that decision pay off. "We're not saying you shouldn't pay points, but too many borrowers were paying too many points," Yavas says. Say a borrower can pay one point, or \$5,000, to lower a 5.375% rate to 5% on a 30-year \$500,000 loan. That's almost \$116 a month. You would have to have the mortgage 43 months before you've recouped the points.

BEWARE OF PREPAYMENT PENALTIES

IT'S STANDARD PRACTICE for lenders to charge six months' interest on 80% of the outstanding balance if you refinance and pay off the loan within a year and up to five years. Banks offer better rates on loans with penalties, so if you choose one, know what you're getting into. The danger is when you're speculating on a little money down, and the property fails to appreciate. If interest rates go down and you want to refinance, a substantial prepayment penalty could wipe out the benefit. **||**



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E-rope, shown here, was designed by Chul Min Kang, Miju Kim and Sung Hui Lim of Pratt Institute and was awarded a Bronze IDEA in 2006.

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3. Reading the ROM literature and reluctantly understanding it.
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6. Becoming a ROM enthusiast and trying to persuade friends.
7. Being ignored and ridiculed by the friends who think you've lost your mind.
8. After a year of using the ROM your friends admiring your good shape.
9. You telling them (again) that you only exercise those 4 minutes per day.
10. Those friends reluctantly renting the ROM for a 30 day trial.

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BY MARA DER HOVANESIAN

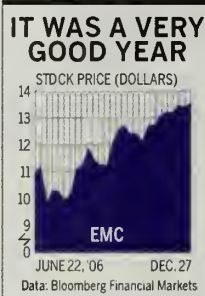
ACQUISITIONS HAVE EMC EXPANDING BEYOND DATA STORAGE.

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LINEAR TECHNOLOGY WILL BE FIRST WITH A NEW LINE OF CHIPS.

EMC: A Fresh Tech Star

IN 2000, WHEN TECH STOCKS were all the rage, EMC stood out as a storied darling. A specialist in data storage, the company watched its share price hit a peak of 100—"a complete joke that we all should have shorted," recalls Jerome Heppelmann, CEO of Liberty Ridge Capital in Berwyn, Pa., which has \$625 million under management. Now at 13.47, EMC is a Heppelmann favorite, and the stock is up 39% from an Aug. 9 low. Since 2002 the company has quietly doubled its revenues (it boasts an 18% annualized growth rate, tops among its peers), as acquisitions such as RSA Security, VMware, and Documentum have paid off by rounding out EMC's offerings, from storage to security. Plus, the Hopkinton (Mass.) outfit is buying back stock at a healthy clip—at least \$3.6 billion in 2006. Heppelmann forecasts that the company will earn 74¢ a share next year (adjusted for stock-option expenses), up 21% from an estimated 61¢ this year. Says Heppelmann, who doesn't give price targets: "It's very cheap. It has a great market share, a great balance sheet, and free cash flow that it's using to buy back stock. The stock can go much, much higher."



Green Mountain Could Really Percolate

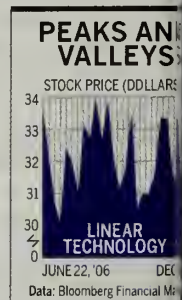
IN DECEMBER, 2005, THIS COLUMN recommended Green Mountain Coffee Roasters as a play on America's love affair with coffee. The stock is up 18% since then, to 48.80. But long-term growth investor Richard Driehaus of Driehaus Capital Management in Chicago, which manages \$3 billion, says the prospects are hot. Driehaus calls Green Mountain the "best retail story out there. This is like the razor to Gillette or the printer cartridge to Hewlett-Packard." Some investors got the jitters when the company reported an earnings hit for its fiscal fourth quarter ended Sept. 30: Net income dropped 37%, to \$1.5 million, or 19¢ per share, mostly because of costs related to its June acquisition of Keurig, which sells single-cup brewing systems. They overlooked that sales zoomed 87% in the quarter, in part because Keurig added \$21.6 million to revenues. Sales have been brisk at Macy's, Bed Bath & Beyond, Target, and Costco, says Mitchell

Pinheiro of Janney Montgomery Scott, who on Dec. 6 reiterated his "buy" rating and his 12-month price target of 60. He sees earnings per share jumping from \$1.07 in fiscal 2006, to \$1.51 in 2007. Driehaus adds that because the Waterbury (Vt.) company now roasts, distributes, and sells organic coffee products, its vertical business model will allow it to ink more deals the way it did last year with McDonald's, which in part credits better sales at 650 of its New England and New York store better-tasting coffee. (Individual packets allow for coffee brewed on the spot, rather than turn bitter in hours-old pot.) Driehaus figures the stock could quadruple in a few years.



What's Powering Linear Technology

SHARES OF LINEAR TECHNOLOGY have been stuck in a narrow band for several years. And new revenue warnings elicited downgrades from the Street. But Scott Armiger, fund manager at Christiana Bank & Trust in Greenville, Del., is a buyer. Linear, he says, has the highest profit margins in the semiconductor industry, and the company will soon be first on the market with a new series of signal-processing chips for high-growth markets, including PCs, cell phones, and MP3 players. He sees earnings growing at 20%, vs. a 15% average for the industry. The company is debt-free, and 70% of its business is outside the U.S., which bodes well in a falling-dollar environment, says Armiger. Plus, it has a "1.9% dividend yield that is rare in tech," says Armiger, who pegs the 30.30 stock at 36 in 12 months. Or Dec. 12, Adam Parker of Sanford C. Bernstein rated the stock a "buy," with a 40 target. ■



Gene Marcial is on vacation.

BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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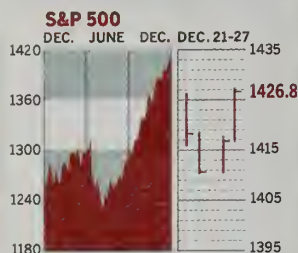
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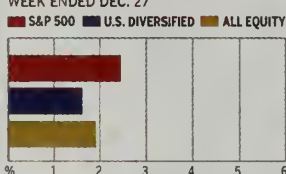
COMMENTARY

Investors showed some holiday cheer following the Christmas weekend. The Dow broke through 12,500 for the first time ever. Better-than-expected new-home sales gave stocks a boost, especially homebuilders. Toll Brothers climbed 1.9%, and Lennar jumped 2.7% on Dec. 27. Mild temperatures across much of the U.S. caused energy stocks to cool.

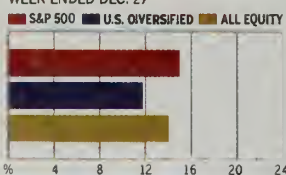
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	DEC. 27	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1426.8	0.2	14.3	13.6
Dow Jones Industrials	12,510.6	0.4	16.7	16.1
NASDAQ Composite	2431.2	0.1	10.2	9.2
S&P MidCap 400	813.5	0.6	10.2	10.0
S&P SmallCap 600	404.9	1.2	15.5	15.1
DJ Wilshire 5000	14,306.9	0.3	14.5	13.9

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	801.4	-0.2	8.0	7.6
BW Info Tech 100**	447.7	0.3	17.7	16.5
S&P/Citigroup Growth	656.0	0.0	10.0	9.2
S&P/Citigroup Value	769.4	0.5	18.8	18.1
S&P Energy	458.9	-0.1	23.1	24.2
S&P Financials	499.9	0.8	17.2	16.4
S&P REIT	197.8	-0.1	29.3	27.4
S&P Transportation	264.2	0.3	5.8	5.0
S&P Utilities	187.6	0.4	17.5	16.4
GSTI Internet	202.2	-0.1	-1.4	-2.7
PSE Technology	879.1	-0.1	5.1	4.1

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	DEC. 27	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1981.8	-0.1	31.1	31.1
London (FT-SE 100)	6245.2	0.8	11.1	11.1
Paris (CAC 40)	5540.0	0.5	17.5	17.5
Frankfurt (DAX)	6608.9	0.3	22.2	22.2
Tokyo (NIKKEI 225)	17,223.2	1.2	6.9	6.9
Hong Kong (Hang Seng)	19,607.0	1.9	31.8	31.8
Toronto (S&P/TSX Composite)	12,852.6	0.5	14.0	14.0
Mexico City (IPC)	26,196.7	3.2	47.1	47.1

FUNDAMENTALS

	DEC. 26	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.77%	1.76%	1.81%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.9	18.1
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.4	15.1
First Call Earnings Revision*	0.18%	0.17%	-2.39%

*First Call

TECHNICAL INDICATORS

	DEC. 26	WEEK AGO	YEAR AGO
S&P 500 200-day average	1316.4	1313.7	Positi
Stocks above 200-day average	73.0%	74.0%	Negati
Options: Put/call ratio	0.75	0.80	Positi
Insiders: Vickers NYSE Sell/buy ratio	NA	6.88	↓

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	19.3	Steel	79.5
Drug Chains	15.0	Divsfd. Metals & Mining	44.9
Health-Care Services	14.3	Broadcasting	42.4
Forest Products	12.6	Intgrd. Telecmm. Svcs.	41.6
Fertilizers & Ag. Chems.	12.6	Investmt. Bnkg. & Brkrge.	39.4

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entertnmt. Sftwre.	-10.6	Education Services	-
Computer Retailers	-9.5	Homebuilding	-
Electric Mfg. Svcs.	-6	Internet Software	-
REITs - Industrial	-5.4	Electric Mfg. Svcs.	-
Air Freight & Couriers	-4.9	Internet Retailers	-

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	7.0	Latin America	40.8
Pacific/Asia ex-Japan	5.9	Pacific/Asia ex-Japan	36.7
Japan	5.0	Precious Metals	33.2
Diversified Emerging Markets	4.7	Europe	31.4
LAGGARDS		LAGGARDS	
Precious Metals	-1.8	Japan	-0.7
Natural Resources	-0.3	Health	3.8
Technology	-0.1	Technology	5.9
Real Estate	0.1	Large-cap Growth	6.2

EQUITY FUNDS

4 WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Ultra Japan Inv	17.9	Dreyfus Prem. Grtr. China A	79.1
DireXn. Japan Bull 2X Inv.	17.0	Oberweis China Opport.	78.7
Legg Mason Eq. Tr. Bal. Prim	14.8	iShares FTSE Xha. Ch. 25 kdb.	66.8
Dreyfus Prem. Grtr. China A	14.0	ING Russia A	63.9
LAGGARDS		LAGGARDS	
Gab. Wldnd. Sm. Cap Val. A	-18.7	Ameritor Investment	-85.7
ProFds UltSh. Japan Inv.	-15.0	DireXn. Emrg. Mkts. Short	-49.6
ProFds UltSh. Emrg. Mkts. Inv.	-12.8	DireXn. Sm. Cap Bear 2.5X	-30.8
Waddell & Reed Adv. Asst. A	-12.7	ProFds. UltSh. Sm. Cap Inv.	-25.9

INTEREST RATES

KEY RATES

	DEC. 27	WEEK AGO	YEAR AGO
Money Market Funds	4.88%	4.87%	3.1
90-Day Treasury Bills	4.97	4.96	
2-Year Treasury Notes	4.78	4.71	
10-Year Treasury Notes	4.66	4.60	
30-Year Treasury Bonds	4.78	4.73	
30-Year Fixed Mortgage†	6.00	6.04	

†BancQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.75%	4.1
Taxable Equivalent	5.36	5.9
Insured Revenue Bonds	3.89	4.3
Taxable Equivalent	5.56	6.2

THE WEEK AHEAD

PURCHASING MANAGERS' INDEX

Tuesday, Jan. 2, 10 a.m., EST » The Institute for Supply Management's December factory activity index probably held at 49.5% for a second straight period. That's the consensus estimate among economists surveyed by Action Economics. A reading under 50% implies a decline in activity among manufacturers.

FOMC MINUTES **Tuesday, Jan. 2, 2 p.m., EST** » The Federal

Reserve's Open Market Committee issues the minutes of its Dec. 12 monetary policy meeting. Fed watchers will read the notes to gauge how much emphasis the central bank is placing on inflation relative to softer economic growth.

CONSTRUCTION SPENDING

Wednesday, Jan. 3, 10 a.m., EST » November building outlays likely fell 0.3%, after a larger-than-expected 1% drop in October.

FACTORY INVENTORIES

Thursday, Jan. 4, 10 a.m., EST » Manufacturing inventories probably rose 0.3% in November, after an October gain of 0.4%.
EMPLOYMENT **Friday, Jan. 5, 8:30 a.m., EST** » Nonfarm payrolls in December are forecast to have risen by 110,000 workers, after a gain of 132,000 in November. The jobless rate probably held at 4.5%. Average hourly earnings most likely rose by 0.3%.

The *BusinessWeek* production index fell to 284.2 for the week ended Dec. 16, a 6.9% gain from a year ago. Before calculation of the four-week moving average, the index eased to 282.9.

BusinessWeek .com

For the BW50, more investment data, and the components of production index visit www.businessweek.com/extras

1

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Modern Snake Oil?

JURAL CAUSES Death, Lies, and Politics in America's Vitamin and Herbal Supplement Industry
 an Hurley; Broadway; 324pp; \$23.95

easy to hate the pharmaceutical industry. Prescription drugs are expensive, sometimes dangerous, and often overhyped. So why not turn to so-called natural remedies, the kinds of herbs and minerals that have been used for thousands of years by indigenous peoples?

That's what Sue Gilliatt, a 49-year-old in Indianapolis, figured when she decided to treat a benign tumor on her nose with a product made by a Bahamas company, Alpha Omega Labs. On its Web site, Alpha Omega blasts the "Cancer Industry" for preventing "safe, inexpensive, often more effective treatments from reaching the mainstream." That sentiment resonates with the demographic most likely to buy alternative medicine: college-educated people between the ages of 36 and 50 who have annual incomes over \$50,000. Gilliatt called Alpha Omega and bought a salve called Cansema, priced at \$95 a jar. She added in a paste based on herb bloodroot. After two weeks of burning sensation and oozing pus—all of it, according to Alpha Omega, that the product was working—she removed the bandage, looked in the mirror, and discovered that her nose was, well, gone. "I had been con men," she now admits.

Gilliatt's horrifying story opens *Natural Causes: Death, Lies, and Politics in America's Vitamin and Herbal Supplement Industry*, an angry and detailed exposé of the largely unregulated field. Medical writer Dan Hurley has gathered considerable data on the steady flow of deaths, disfigurements, injuries linked to this \$21 billion-a-year business. More than 60% of Americans use herbal and dietary supplements, and the Food & Drug Administration (FDA) has virtually no authority over these so-called safe and natural wares. The book is a sometimes strident wake-up call. After all, how many people do you know who take vitamin C and melatonin to prevent colds, melatonin for insomnia, or St. John's wort for depression? Reputable study after study has failed to show that these are effective.

Questionable supplements have a long history in America. In 1830, a Massachusetts merchant was fined for selling a fake scurvy cure that was merely water. And in the late 19th century there really were snake-oil salesmen, led by Clark Stanley, the self-described "Rattlesnake King." Stanley made

a fortune selling his pain liniment, reputedly made from oil extracted from snakes, until 1915, when the U.S. government shut him down for making false claims (and no, there was no snake oil in the product). Stanley would have an easier time of it today. In 1976, Congress barred the FDA from regulating the contents of vitamin and mineral supplements, saying they were natural products and should be treated like food, not drugs. The FDA was further defanged by the Dietary Supplement Health & Education Act (DSHEA) of 1991. The FDA had been trying to gain more control over supplements in the wake of the L-tryptophan scandal of the late 1980s, when hundreds

suffered life-threatening illnesses after taking the supplement for insomnia. But the herbal industry fought back, spending millions on lobbyists and campaign contributions.

Then-FDA Commissioner David A. Kessler testified that supplements should be treated much the same as drugs. But his rational arguments carried little weight with senators. The supplements industry ended up with the right to make all kinds of claims about their products without proof, and sales took off. The only supplements with unqualified support are calcium and vitamin D for women at risk of osteoporosis, folate for pregnant women, and fish oil, containing omega-3 fatty acids, for lowering cholesterol and blood pressure. Multivitamins, taken by more than half of

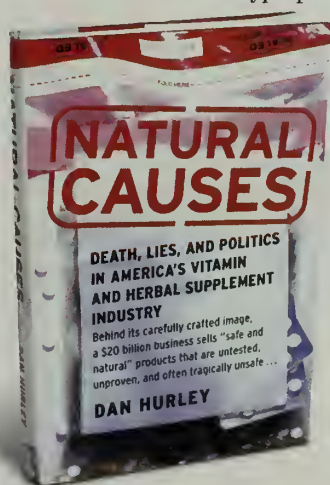
all adult Americans, have been largely dismissed by the National Institutes of Health.

Hurley offers a thorough, well-written account of the fallout from the DSHEA. He describes case after case, from ephedra, the weight-loss product that contributed to the death of Baltimore Orioles pitcher Steve Bechler, to teenagers dying from supplements meant to get them high "naturally." But his irate tone, however justified, gets

wearing. And while properly attacking hucksters' claims, he lets another key player pretty much off the hook.

That would be us, the customers. Only at the very end of his book does Hurley point out that "in an age of post-modern cynicism toward experts, doctors, politicians, and reporters of every stripe, we have made a special exception for the claims of supplement manufacturers—precisely because they prey upon our skepticism toward all other sources." In other words, we're still buying that snake oil. ■

—By Catherine Arnst



The FDA has virtually no say over the \$21 billion supplements business



A Medicare Intervention

It's an economic truism that the more society is willing to pay for something, the more of it we get. Just look at all the services provided by Medicare. Already costing \$370 billion annually, the program is projected to balloon in future years as aging boomers require more and costlier care. Unfortunately, Medicare has long upended another economic principle,

the one about the consumer growing increasingly cost-sensitive as spending on a commodity increases. Instead, there are virtually no incentives in the program for beneficiaries to care about how those dollars are spent.

The problem is straightforward. Why would anyone on Medicare question the cost of a test, the value of a procedure, or the need for all kinds of high- and low-tech medical equipment when the bill for most of what they get is paid not by them but by someone else (in this case, taxpayers)? So if either party is serious about showing it can govern effectively, getting control of Medicare in 2007 would be a good start.

It's not that no one has tried to fix Medicare. Numerous ideas have been put forward, and many efforts made over the past 20 years. But whether these ideas failed because they weren't enacted, or were enacted but neglected to provide effective answers, they failed nonetheless, largely for two reasons: They didn't engage stakeholders in an actual solution, and they asked beneficiaries to accept less than they were already getting without giving them anything in return.

That suggests America needs to stop thinking that new forms of health-care service allocation, price controls, and bureaucratic measures will do the trick. They haven't fixed Medicare in the past, and there is no reason to think they will in the future. Instead, we need a way to mobilize recipients into an army ready to battle uncontrolled Medicare spending. Remember that all modern armies have one thing in common: Members get paid. Every Medicare beneficiary must be paid to be part of the Medicare solution. Here is how the system can work:

Medicare beneficiaries would receive an annual rebate of 50¢ for each dollar they save the program. If someone saves Medicare \$500, she would get \$250. For saving Medicare \$5,000, a beneficiary would get \$2,500. It's that simple.

The other simple idea under this approach is that all Medicare beneficiaries would continue to get the same coverage they are entitled to under current law. This plan is not about denying

people health-care coverage; it's about giving them incentive to make the kinds of choices they would make if they had to reach into their own pockets to pay their bills.

Beneficiaries' spending decisions would set their annual rebate level. A rolling three-year average, with the lowest two of the three determining the average, would set an individual's savings target. Beating that would trigger a rebate. This would help ensure that any one year of high spending (say, on heart surgery) does not create a skewed average and a subsequent windfall just for returning to relative good health. It would also limit the ability to game the system by shifting spending from one year to the next.

In the first two years of Medicare coverage, beneficiaries will not have a Medicare history to establish savings targets. To navigate this, and to make sure good choices (rather than good health) set the rebate level, the spending level of the lowest 50% of first-year beneficiaries should set rebate targets. After that, the rebate would be determined by individual spending patterns.

It is, of course, impossible to predict with absolute certainty this reform's fiscal effect. But the 35 million nondisabled Medicare beneficiaries reduced their spending by a mere 5%, then \$13.12 billion would be saved annually. And each additional 1% reduction adds \$2.62 billion in further savings. Half of that would go to the federal government, and the other half to those Medicare

beneficiaries actively helping to control Medicare expenditure.

Congress should proceed by testing these ideas. A three-year, large-scale pilot program, for example, would provide the opportunity to compare the savings of participants against a control group and to deal with the possibility of rewarding false savings. That's a sensible yet dramatic step. But decades have been spent trying to rein in Medicare's growth. Rule-based schemes have failed miserably. It's time to give the marketplace—consumers and providers alike—the opportunity to succeed where government has not. ■

**We can fix
the system
by paying
beneficiaries
to help
control
spending**

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Steven Hofman, an adviser to CEOs, is former director of research and policy for the House Republican leadership.

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The High Cost of Corruption

What is the impact of corruption on a nation's economy? My impression is that there is no major corruption in America, which explains its entrepreneurial success. Is there corruption in the U.S. in any form or by another name?

—R.M. Subbiah, Kuala Lumpur, Malaysia

Like heat, humidity, and tax rates, corruption falls into the “everything is relative” category. We happen to live in Boston, home of the Big Dig, said to be the second-largest public works project in history. The Big Dig, launched in 1991 to bury many of the city’s highways and create a wide swath of parkland, was supposed to be concluded in 2001 for \$2.8 billion. It may be done by 2010, with a final price tag of \$14.6 billion. Now, anyone who has ever put in a new kitchen knows that renovations always cost twice what you expect, but an \$11 billion overrun certainly seems to suggest that, yes, there is corruption in America.

But it’s rare—comparatively. We recently returned from a trip to Latin America where we met with hundreds of business people in Brazil and Argentina. Their stories of ubiquitous corruption, much of it at the hands of the government, were chilling. Tax evasion is widespread; enforcement is spotty. In Argentina, several CEOs told us that if you attempt to conduct business without playing by the unwritten rules imposed by layer after layer of government bureaucrats, an army of tax auditors arrives at your door, paralyzing your company and often times staying until an employee or two goes to jail.

We don’t mean to single out Latin America. Even in Europe, business-as-usual can include illegal activities. Yes, the situation has improved in the past decade. But European CEOs have told us that bribery was once so pervasive—in Germany, bribes were legal through most of the ’90s—that they often did not know which of their own employees they could trust. Today, corruption is particularly rampant in the developing world, from India to China, and through Eastern Europe to Russia. It remains one of the main reasons that capitalism cannot take root in Africa. Corruption can make it just too expensive to start a business, or in many cases, to keep a small one running.

By contrast, the relative lack of corruption in the U.S. is

**The lack of
graft here is
one reason
we lead
the world
in business
creation**

a key reason, along with an entrepreneurial culture and the wide availability of venture capital, that we lead the world in business creation. Virtually no one starting a company in the U.S. today, and no one funding one, has to worry about covering the hidden costs of bribes, payoffs, and kickbacks. They just have to worry about coming up with great ideas, getting the best people, and delivering a terrific execution. That’s hard enough!

Yes, the U.S. has its share of corruption in public works projects. And we did have a spate of corporate scandals—Enron, WorldCom, and Tyco, to name the most notorious. But those were mainly cases of individual fraud and malfeasance, not systemic corruption. We really don’t have that. Which is why when you compare the sustained health and entrepreneurial energy of the American economy with the more corrupt countries around the world, your question says it all: Corruption is a competitive disadvantage.

When it comes to getting an entry-level job with a corporation, does it matter where a person went to college?

—Ben Santacroce, Naples

Every situation is unique, of course, but in general, college mainly matters if the person in question is sort of average. O.K. grades, O.K. recommendations, O.K. everything. In that case, a brand-name degree comes in quite handy. A Princeton or Williams stamp of approval has a way of opening doors that might be closed to a similarly average student from a state school. Hiring companies will hold their noses and say, “Well, he did graduate from Cachet College....”

But stars are stars no matter where they go to school. We’re talking now about students who have earned 3.5 averages or better, held leadership positions on campus, because of their hard work and great attitudes, have garnered enthusiastic letters of recommendation from professors and summer employers. This crowd of winners is welcomed anywhere with, perhaps, one exception: consulting firms. For reasons of prestige, they hire almost exclusively from about a dozen top-tier schools. It’s their loss.

That said, how a person did at school—or to your question, where he or she went to school—becomes irrelevant after about one month on the job. At that point, a person’s performance takes over as the driver of career success, rendering college to its rightful place as a happy memory.

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast, go to www.businessweek.com/search/podcasting.htm.

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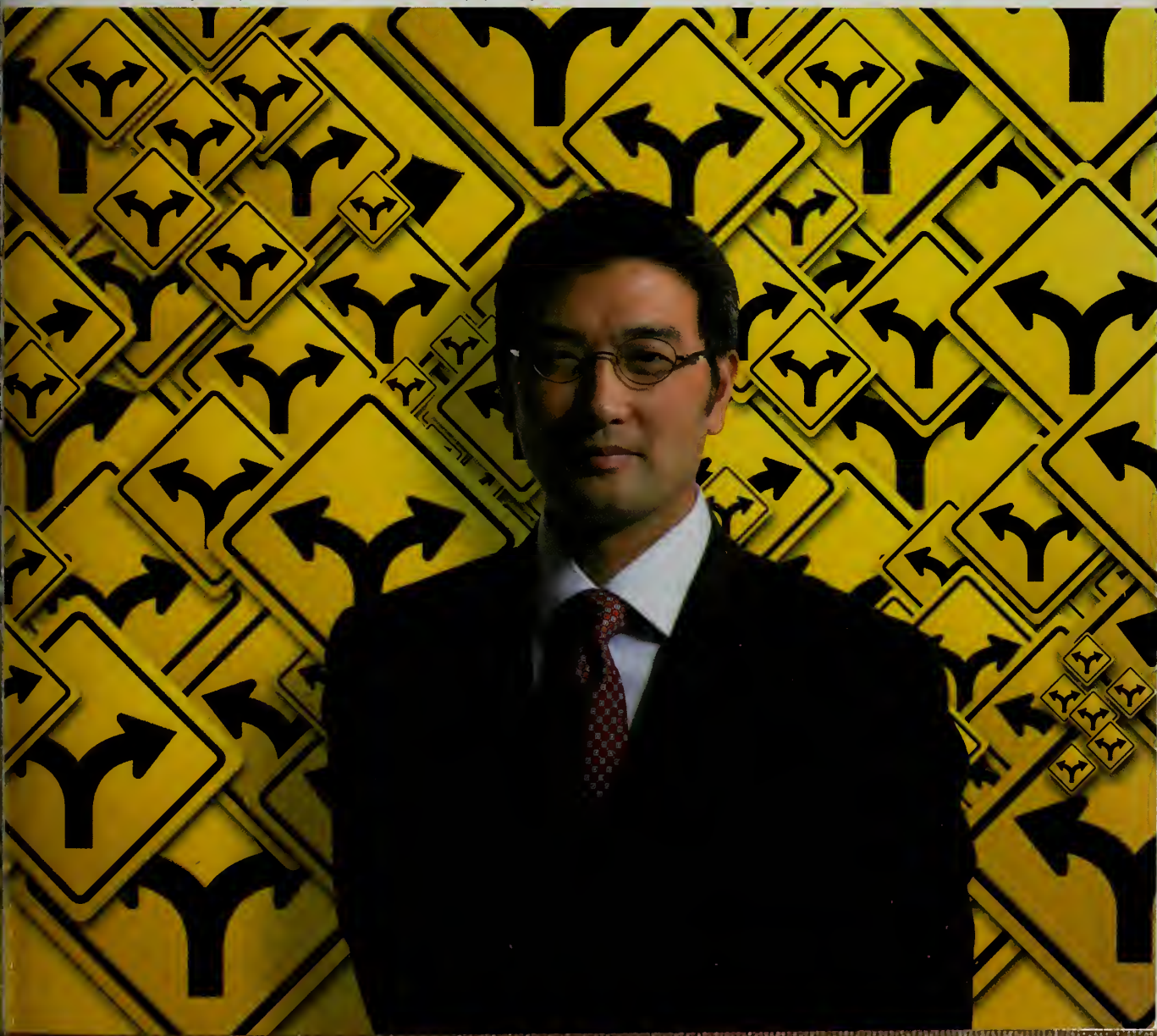
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Blowup At Home Depot

Behind the dramatic
fall of an imperial CEO

By BRIAN GROW (P.56)



Bob Nardelli

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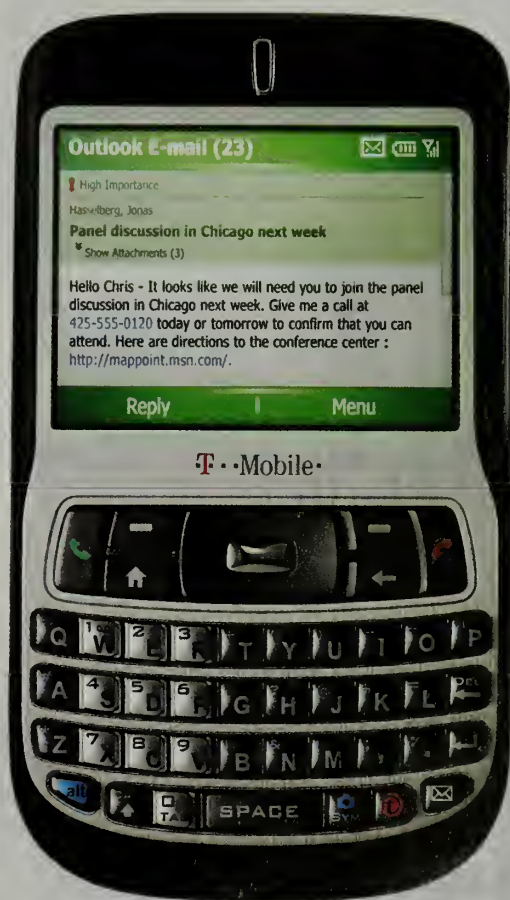


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5 News You Need to Know

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News & Insights

Gift-Card Fraud

Gift-card fraudsters love the lucrative and popular holiday favorites, but horror stories are starting to worry consumers

Remember that Scarf You Hated?

After you returned it, an outsourcer probably resold it

Chasing Delphi

Offers to bring it out of bankruptcy reveal starkly different approaches

A Slick Pitch for 'Negative Calories'

Unilever and Nestlé join to market a "calorie-negative" drink that raises doubts

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Emerging Markets Get Riskier

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Lamborghini Gains on Ferrari

Owner Audi is revving up production of the sports car

Telecom: Undersea Peril

Industry is on notice after quakes near deep-sea cables

Heineken's Light Starts to Shine

Premium brew is beginning to have impact on the big boys

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For additional insights into European and Asian business, please go to www.businessweek.com/globalbiz

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Business Outlook

Cooper says the declining dollar is a downer. As a matter of fact, there are advantages to a further slide

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Today's Tech Dynamos

Is technology still a high-growth industry? Despite the success of MySpace and YouTube, much has been made of the sector's sluggishness following the dot-com bust. But BusinessWeek.com's annual **Tech Hot Growth 50** ranking makes it clear that there is plenty of headroom remaining in the industry—even hot, bubble-like growth in certain places. The nature of that growth, however, has changed dramatically. No longer do all companies in technology have a strong tailwind of 15% to 25% increases. Instead, the overall sector is growing at single-digit rates. The result? To grow at exceptional rates, tech companies need to deliver **exceptional performance**. Apple has done it with **standout innovation** in digital music and beyond. Google is building **a brand new model** for making information available to one and all. Even companies in brutally competitive fields—such as telecom or corporate software—can deliver strong results. Just consider how AT&T and Oracle have gobbled up their rivals to make revenues surge. It's certainly **not like the old days**, but there's plenty of growth to be had in the tech industry. Go to www.businessweek.com/go/07/tech50 for this and more.

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"The pendulum of economic power might well begin to shift from capital back to labor."

—Stephen S. Roach, chief global economist, Morgan Stanley, on global political shifts that could lead to increased workers' pay and job security in 2007, as reported by Bloomberg

EDITED BY DEBORAH STEAD

EXECUTIVE SEARCH

Who's On Board at Tyco

HE COMPLETES one of the largest corporate breakups in American history, Tyco International CEO Edward Breen (right) has been recruiting two entirely new boards. And *BusinessWeek* learned that no fewer than 18 independent directors have signed up. By April, Tyco, with a market valuation of \$61 billion, will have spun two new companies—**Tyco Electronics** and **Tyco Healthcare**—to be run by Breen's former tenants Thomas Lynch and Richard Meelia. Breen will remain in charge of the protection, security, and industrial electronics businesses.

At Tyco Healthcare, the board recruits include Tadataka "Tachi" Yamada, president of the Bill & Melinda Gates Foundation Global Health Program. Among the directors at Tyco Electronics: Lawrence Smith, Comcast's retiring CEO (and an architect of its acquisitions strategy) and management guru Ram Charan, who has advised the likes of General Electric and Verizon. Dennis Carey, a partner at executive search firm Spencer Stuart, spent eight months helping Tyco evaluate 300 potential candidates. To fill the posts

of nonexecutive chairmen, Breen, with Tyco's lead director John Krol, looked for people with both CEO and board experience, the better to guide Lynch and Meelia with their first CEO gigs. For the electronics unit, he chose **American Standard Companies'** CEO Frederic Poses; for health care, **Praxair** Chairman Dennis Reilly.

The other directors (including retired **Sprint** Nextel Chairman Timothy Donahue and **Waste Management** CEO David Steiner) have expertise in everything from HR to acquisitions. "Our health-care business will probably do some M&A activity down the road," says Breen, as the electronics unit does some "pruning." —Emily Thornton

For a complete list of the directors, see "Your Tyco Cast List," at www.businessweek.com/extras.



THE BIG PICTURE

MOST YOUNG workers support the provision of the 2006 pension reform that makes it easier for companies to automatically enroll eligible new hires in defined contribution plans. Indeed, a recent survey shows many of these workers would be happy to hand over other pension decisions.

PERCENTAGE OF WORKERS 21 TO 30 YEARS OLD WHO WOULD BE "OPTIMISTIC" OR "GRATEFUL" ABOUT:

Automatic enrollment in the pension plan
66%

An automatic minimum contribution amount
54%

Automatic increases in contribution amounts
51%

A spectrum of automatic features, including asset reallocation
57%

Prudential Retirement survey of 300 U.S. employees 21 to 30 years old, 2006

D-I-V-O-R-C-E

A SITE FOR SORE WIVES

Broadway and broadband—the convergence nobody saw coming. In advance of the spring 2008 opening of their Broadway production of *The First Wives Club*—based on the popular book and movie—producers Paul Lambert and Jonas Neilson plan to start up First Wives World, an online social networking site for divorcees.

Slated to launch this spring, it will offer ticket



sales, forums, blogs, and, soon after, a dating service. The two producers plan to invest \$8 million to \$10 million to make it a business. “*First Wives Club* does have a brand that means something for women,” says Lambert.

Wharton management professor Eric Clemons, who is using the launch as a case study, says that with its specific issue and audience, the site will have a better chance than most MySpace wannabes. Still, women over 35, a good chunk of the target audience, are social networking laggards. And what about the risk of losing advertisers to some hotter, younger site?

—Heather Green



HOT HYBRID
The FT-HS concept car

HEAD-TURNER

TOYOTA'S DRIVE FOR SEX APPEAL

TOYOTA HAS a great brand, a reputation for bullet-proof quality, and the money to keep cranking out new cars. But there's one thing missing from its line: sex appeal. The company will try to change that at the Detroit auto show, which opens to the media on Jan. 7, when it unwraps the FT-HS sports car concept—a model about

the size of a Nissan 350Z sports car but with a much edgier look.

It'll be an ambitious project, if Toyota winds up building the FT-HS (short for “future Toyota hybrid sport”). Engineers are planning on a tire-burning 400 horsepower but also a hybrid electric drive system to boost fuel economy—all for a target sticker price of around \$35,000.

Three designers at the company's Newport Beach (Calif.) studio produced 16 different sketches before Toyota settled on the look it

wanted. “We think this is the same class as Porsches, Corvettes, and Ferraris,” says Kevin Hunter, the studio's vice president.

The FT-HS is the carmaker's latest attempt to go sporty. Its recent MR2 was a flop, as was its earlier Supra, which the public deemed too pricey at \$40,000. (It was dropped in 1998.) “That is what they need to do,” says Eric Noble, president of The CarLab, an automotive consulting firm in Orange, Calif. “It's the right look for Toyota and should be a hit at the show.” —David W.

GOOD HUSBANDRY

A SEAL OF APPROVAL FOR THE MILK OF HUMAN KINDNESS

CONSUMERS who are knowledgeable about such things know that food labels such as “organic,” “natural,” or even “free-range” don't necessarily guarantee good conditions for the animals that produced the meat, milk, or eggs found inside the packaging. So the Animal Welfare Institute recently introduced another tag for consumers to ponder: the “Animal Welfare Approved” label.

The seal, the institute says, assures that the animals

providing such products haven't suffered chopped beaks, docked tails, or lives spent away from sunlight. The initiative may have a

limited impact, because the institute is granting the label only to qualifying family farms. AWI



President Cathy Liss says that awarding the seal to big farm operations carries the risk that they will apply stringent standards to only part of their operations.

The institute's aim, Liss says, is to go beyond the standards upheld by labels like the American Humane Assn.'s “Free Farmed Certified” seal or Whole Foods' “Animal Compassionate” stamp, of which endorse corporate farms that agree to meet their standards. That said, the new label still fails to

impress People for the Ethical Treatment of Animals, who believe the real cruelty is eating meat or drinking milk in the first place.

—Diane E.

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PET PROJECTS

HOW FLORIDA PUTS ON THE DOG—AND CAT

ONE OF the best-selling books in Palm Beach, Fla., this season isn't a poolside mystery or a collection of art reprints. It's *Palm Beach Pet Society*, a photo array of the resort town's most pampered pets—and in some cases, their owners. Retailing for \$20 (proceeds go to local animal charities), the 140-page coffee-table book was published by *Palm Beach Society* magazine, which flew in New York pet photographer Jim Dratfield, whose clients include Jennifer Aniston and Henry Kissinger, to do the cover. Sales at the town's four



bookstores have hit almost 2,000 copies so far, one for every 15 Palm Beach winter residents. (A few bookshops in Boca Raton and Miami's South Beach also sell the book.) Among the photos: portraits of female cats and dogs wearing an estimated \$16 million to \$20 million worth of bling borrowed from

local jewelry outlets, among them **Tiffany** and **Chopard**. Males were shot "driving" luxury vehicles.

Yes, the society folks in town can be a bit over-the-top about their animals, admits the publisher's owner, James Sheeran. "People absolutely go crazy for these pets," he says, with some women confiding to him that "my dog is more important than my husband to me."

—Lindsey Gerdes

ROYAL FLUSH

WHAT DO YOU get when you combine Japan's love of gadgetry with its cleanliness obsession?

The highest-tech toilets on the planet.

Just out: the "Alauno" (right), created by award-winning industrial designer Naoto

Fukasawa and manufactured by Matsushita Electric Works. For a mere \$3,400, consumers get a water-conserving spiral-shaped bowl that self-cleans with every flush (Air bubbles and a squirt of detergent do the scrubbing.) There are also light-emitting diodes at the foot of the toilet and inside the bowl to make the unit easy to find in the dark.

—Kenji Hall and Hiroko Tashiro

BLOGSPOTTING COFFEE TALK

www.starbucks.gossip.typepad.com

» WHY READ IT: Check out the site for a view of the world filtered through **Starbucks**. This includes posts like the one debating the ethics of purchasing an espresso and then adding lots and lots of the milk provided free at the counter to create a discounted latte-like concoction. Not affiliated with the corporation, the blog (administered by Jim Romenesko, who also runs a popular media site) explores burning questions such as if and when it's appropriate for baristas to offer drinks on the house and whether customers' tipping habits change during the holidays.

—Lindsey Gerdes



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HONDA
The Power of Dreams

ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

When You're the Abusive Boss's Pet

I was recently hired by a new manager who is hated by his staff. Because he hired me, I guess, he treats me much better than he treats the others, toward whom he's hypercritical and dismissive. With me, he adopts an *entre nous* attitude, complaining about everyone else. I'm uncomfortable with this. I need to develop good rapport with my colleagues, but I can't see that happening if I remain the boss's pet.

—Anonymous, New York

YOU'RE RIGHT: as long as this favoritism lasts you'll never be able to bond with your co-workers. And you'd better act fast to change the situation. The longer you wait, the more you risk being stigmatized permanently.

A warning, though: Figuring out a solution will require mustering some empathy for this manager. He has obviously gotten off to an abysmal start, and my bet is that he's probably lonely or depressed in his new job (and maybe in the rest of his life, too). That may be one reason he's latched onto you, the other newcomer, and effectively split you off from your peers.

His contempt toward his staff also sounds defensive—his way of deflecting the fear that he's the one on trial in the department. By



taking you into his confidence and maligning the others, he's consoling himself, in part by trying to poison your impressions of the staff.

You can't pretend this mess doesn't exist, so you've got to say something to your co-workers. Don't take a page from your boss's playbook, though, and trash him. Instead, acknowledge the awkwardness and find ways to make it clear that you have a mind of your own. You should also approach your boss privately, and, in the spirit of being helpful to him and to the team, start a discussion about the dynamics you're observing. I wouldn't put it in the context of how he's making you miserable and turning the others against you. That will just make him more defensive and thus even harder to deal with. Rather, offer

some observations about the perception that he has taken you under his wing. While you appreciate his interest, you're concerned that it might be hampering your ability to build relationships with colleagues.

IN TRYING to engage his curiosity about office

dynamics, you stand a better chance of helping him see how he's undermining his own authority. Offer one or two suggestions on what the team really needs from him as a leader. Tactfully, try to counter his dim view of the staff with examples of good work they've done. And admit some of the challenges you faced in making the transition to a new company. He'll feel less alone and more understood. Sadly, if all this doesn't eliminate the unwanted favoritism, you might have to look for another job.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send him questions at analyze@businessweek.com

QUESTION OF THE WEEK

Business was the villain in a bunch of 2006 movies, from *Thank You for Smoking* to *Casino Royale*. Can you think of a pitch for a film in which business looks good?

"Corrupt congressman demands bribes from defense contractor, who realizes that protecting jobs means saying yes. CFO demands perks to keep mum, but heroic exec devises scheme to break congressman. FBI agrees to do the sting."

Reed Hastings, CEO, Netflix

"A company, like Halliburton, decides on Christmas Eve to donate all profits to a veterans' hospital because the CEO meets a dying vet at his local hospital who offers the CEO's only child his kidney. (Don't count on its being made.)"

Esther Newberg, senior VP and co-director, Literary Dept., ICM

"Opening scene from a Truman Show remake: Hero throws a brunch, and a cast of thousands—farmers, coffee growers, café employees—shows up to make everything at ridiculously low prices. It's a wonderful life."

Russell Roberts, economics professor, George Mason University



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(eszopiclone)
1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if

you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice

any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potent effects in the unborn baby when used during the last part of pregnancy. Be sure to tell your doctor if you are pregnant if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of small amounts of LUNESTA on an infant are not known, therefore, as with all other prescription sleep medicines recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you are taking, including medicines you may buy without a prescription and herbal preparations. You should tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get more hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant, you are planning to become pregnant, if you are breastfeeding a baby, or if you are taking LUNESTA.
10. As with all prescription medicines, never take LUNESTA or any other sleep medicine with alcohol. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the lower dose (1 mg) of LUNESTA. Your doctor should choose to start therapy at 2 mg. In general, people under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or chew the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

Rx only



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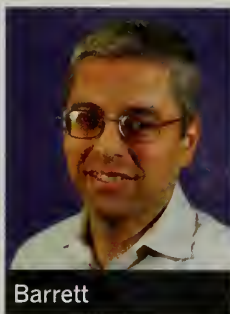
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Islam, USA

FOUR YEARS AGO, when Paul Barrett first began planning an ambitious book on Muslims in America, who would have thought that the topic would still be of such urgent interest

by the time it was published in 2007? But, if anything, intervening events have made Barrett's sensitive, in-depth exploration—adapted in the current issue—more timely and important than ever. With the U.S. even more deeply embroiled in warfare in Iraq and Afghanistan, with sectarian conflict exploding within the Muslim world, with tensions high among Muslim populations in Europe, and with relations strained between some leaders of the Christian and Islamic religions, readers need as much information as they can get about Islam and its adherents.

In the adaptation from his book, *American Islam: The Struggle for the Soul of a Religion* (page 56), Barrett notes



Barrett

that despite being targets of suspicion in the wake of the attacks of September 11, Muslims in the U.S., as a group, offer a textbook illustration of old-fashioned American assimilation. Overall they are prosperous, well-educated, politically active, and successful in business and the professions. They are, in short, not just a suitable

topic for a *BusinessWeek* profile, but surprisingly similar to the demographic profile of our readership. This is a fast-growing segment of American consumers and businesspeople you need to know more about.

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“Maybe it's time executives earn their bonuses...in cold, hard cash based on specific performance criteria for the year.”

—Brian Varley
Elgin, Ill.



any wonder that any rule the Securities & Exchange Commission creates can be manipulated by executives for their own benefit?

Maybe it's time executives earn their bonuses the way the rest of their employees earn them: in cold, hard cash based on specific performance criteria for the year. If the company doesn't make the goal, no bonus. Period. Cash eliminates accounting games and trading schemes and puts a firm number on the worth of an executive.

—Brian Varley
Elgin, Ill.

IN SEARCH OF THE ETHICAL CORPORATE CHIEFTAIN

“INSIDERS WITH A curious edge” (News & Insights, Dec. 18) is yet another sad commentary on the lack of ethics and morality of our corporate executives. One would think that the scandals at companies such as Enron, WorldCom, and Adelphia, and the subsequent jail terms handed out, would have had a cleansing effect on the behavior of the executive class. Instead, we have the ever-expanding scandal of backdated options and now this trading plan. Not even Sarbanes-Oxley, which the U.S. Chamber of Commerce is now trying to gut, seems to

have had much effect. How many millions of dollars of ill-gotten gains does it take to make our corporate chieftains satisfied? The ethical executive seems to have become the exception, rather than the rule.

—Chandran Cheriyan
Sarayoga, Calif.

THE REALITY IS that typically only those at the highest levels have access to the full set of data for a company. Thus, executives have the advantage of seeing trends in the marketplace and their companies' business. Of course, they also set the date for announcing results. Is it

THE IMPORTANCE OF WARREN BUFFETT'S GENEROSITY

THE AMAZING TURNAROUND achieved by James McNerney at Boeing Co. received a full-page picture spread in “I start at a new company” (The Best of 2006, Dec. 18). Your much smaller caricature of Warren Buffett on the same page did not do justice to the magnitude of his generous donation. If we want the rest of the world to adopt free-market policies, first we ought to help them survive. Buffett's \$31 billion donation will bring a lot more progress toward

AmericanAirlines, AA.com and We know why you fly are marks of American Airlines, Inc.



als than \$15 billion worth of Chinook
icopters. It is time to get our pri-
ties straight and recognize our leaders
ordingly.

—Sorin Lotrean
Rego Park, N.Y.

ALL ANDROIDS E CREATED EQUAL

ING BY THE look of the drone pic-
ed in "For GIs, a new eye in the sky"
ience & Technology, Developments
Watch, Dec. 18), I think your article
ant to compare the new drone to *Star*
Wars' R2-D2, instead of C-3PO. R2-D2 is
short, domed garbage can-like droid,
ereas C-3PO is the taller, gold, human-
e droid.

—Randy Levinson
San Jose, Calif.

CORRECTIONS & CLARIFICATIONS

My, My, My" (UpFront, Dec. 25/Jan. 1)
incorrectly described My Savings Plan as a
ells Fargo service that gives users a
onsolidated view of their spending. My
avings Plan lets users set up automatic
ayments into an account to reach a target
avings goal.

BusinessWeek

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Tai Chi at dawn on the Huangpu River overlooking Pudong, Shanghai.

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Vista: Upgrade—or Trade Up?

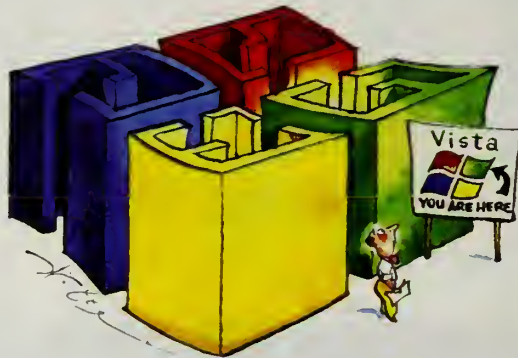
After all the hype and delays, Windows Vista is finally here. Should you rush out and buy a copy when upgrade versions go on sale on Jan. 30? Probably not, given the odds against a satisfactory upgrade experience. But I'd certainly consider speeding up the purchase of a new computer when PCs loaded with Vista become available in a few more weeks.

The marketing barrage that Microsoft has prepared will focus on Vista's new look—the first major design overhaul for Windows in more than a decade. Many of the concepts come from Apple Computer's Mac OS X, but Vista pushes the visual effects much further. Photorealism replaces the garish cartoonishness of Windows XP for everything from program icons to file folders. To cut the confusion that can occur when you have lots of windows open, a thumbnail image pops up when you run your mouse over the program's taskbar icon. Folders look like actual manila folders and show a glimpse of what's inside: a bit of album art for a music folder, a slice of one of your pictures for a photo folder.

All this eye candy is nice, but it's not going to make it any easier to draft a business plan or a budget. And it does come at a price. As is the case with the new version of Microsoft Office, which I wrote about last week, novelty breeds confusion. There are many new ways to display the contents of file windows, for example, including stacking folders that are sorted by size. You won't find the "select all" command on the Edit menu—because the menus have been banished. On the other hand, hitting control-A will still select all the contents of a window, and you can find ways to do everything else you need to do, too. It just takes time to figure it out.

THE MOST IMPORTANT CHANGES IN VISTA are hidden. Microsoft has made some fundamental alterations to fix Windows' notoriously leaky security, as I'll explain next week. But there are other substantive changes that are both visible and useful.

The ability to find things is paramount. Like the Mac's Spotlight search, the new Windows search is accurate and fast. In the best Windows tradition, there are three ways to seek things out, each producing slightly different results. Each window has a search box, and when you enter a search term, Vista brings up matches found in that window's folders. A search box on the start menu searches the entire computer, including program files. And a separate search application lets you specify the scope of desktop search.



It may make more sense to buy the system all loaded on a new PC

The big question is when and how you should move to Vista. Upgrade today? Or just wait and buy an all-new Vista computer down the road?

When Windows XP came out in 2001, I urged people to move quickly to get rid of the hopeless unreliable Windows 98 and the even worse Windows Me. That meant upgrading to XP, and like all earlier Windows upgrades, the process was as much fun as a canal. XP, on the other hand, is good enough that you may just want to make do, for now. Based on the troubles I've had in tests I'd warn against upgrading if you have old accessories, such as printers, or if you run any custom or obscure business software.

If you decide to upgrade anyway, make sure your existing computer has the horsepower to do Vista justice. Any system older than six months or a year may be trouble.

Functions could feel sticky or sluggish, and if the graphics your PC aren't up to snuff, you'll lose the fancy visual effects. You'll need at least a gigabyte of memory. And don't try to pinch pennies. There's a Home Basic version of Vista for \$100, but it lacks many features, including the new graphical design; you want the \$140 Home Premium.

The big risk of upgrading is that you'll get all the confusion of Vista and the looks of XP. With a new made-for-Vista computer, at least you'll know that everything will work. A Vista is a big step forward; in time, you'll want it. ■

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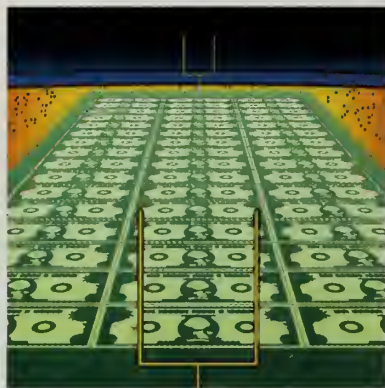
TV's Last Man Standing

On Feb. 4, Super Bowl XLI will draw an enormous audience of fans nailed to their couches, transfixed by television's most enduring spectacle. ♪ The will also be a football game. ♪ As we all know, part of the genius in the marketing of the Super Bowl is that the ads, generally created especially for the telecast, are as much a part of the event as beer burps and thick

necks. Peter Gardiner, chief media officer of ad agency Deutsch, had a fine time attending the Bowl last year save for one thing: "I missed the commercials," he says.

If, like me, you hope one day the Super Bowl and its attendant mania will start shrinking like so many other mass-media spectacles—well, forget it. The broadcast nets scramble to right their listing ships, but the Super Bowl blithely sails on. Last year the single best-rated TV program—besting any series' offering by 2 to 1—was the Super Bowl. In second place, also by a wide margin: the Super Bowl's postgame show. These numbers are extra juiced by the perception that live sports and big events are TiVo-proof, and that with the Super Bowl, there is the expectation that ads are, for once, worth sticking around for. Why don't TV executives and advertisers try this more often?

THE INTERNET is wreaking its creative destruction on much of the media, but in each sector certain properties look likely to escape erosion longer than their brethren. Call them the Last Men Standing. The Last Man Standing in the music business is the classic-rock oldies revue, as typified by Super Bowl XL's half-time entertainment, the Rolling Stones. (Now that they've lasted into middle age, expect U2 to tour, with ever-increasing profits, well into their senescence.) The Last Man Standing among the glossy magazines will be the fashion-heavy portfolio of Condé Nast Publications, as typified by *Vogue*; image-heavy advertising has yet to leak onto the Internet. TV's Last Man is the live event, à la Super Bowl or Oscars. (Not for nothing do ad insiders call the Oscars "the Super Bowl for women.") Savvy marketers talk the talk about the declining effectiveness of the 30-second spot and image advertising in general, as opposed to ads introducing a new product or promotion. But with live events these rules are suspended. Yes, one leading marketing executive told me the Super Bowl is losing its appeal for advertisers. He cited as evidence the fact that the rate of increase for a 30-second spot is slowing; last year, ABC got \$2.5 million for a 30-second



Why the Super Bowl is still the biggest game in town for advertisers

spot. If I were running a network, I'd be pretty happy to take a slight increase on top of that. (Recall that dollars committed in the network upfront—the deeply silly season in which marketers buy most ads for the upcoming season—were flat to down in '05 and '06.)

And so, sharp chief marketing officers like Allstate's Joe Tripodi still concede the Super Bowl's value. "If you have some new news or if you have to launch something," he says, "it's a great venue." The classic example is Apple Computer's famous "1984" ad, which brought out the Macintosh and neatly summarized Apple's us-vs.-them positioning that lingers to this day, not that it stopped the company from belly-flopping in the '80s and '90s.

There are few 1984s because there are few Super Bowls. It boasts a confluence of big advertisers—cars, beer, and burgers—convinced they need adjacency to the high-testosterone event. The current media climate argues against

another TV event causing a spasm of new ads. Agencies and marketing executives are kept on short leashes these days and terrified of failure. Besides, Super Bowl misuses make for expensive flops. Producing an average TV ad costs around \$400,000, says Tripodi. Toss in Super Bowl-size trimming, and you get to a million bucks quickly, not including network time. Today's world will not shrink the Super Bowl, but it has shrunk the stature of conceivable competitors—and the will of advertisers to match event-TV with event-TV as they do in the first week of February. ■

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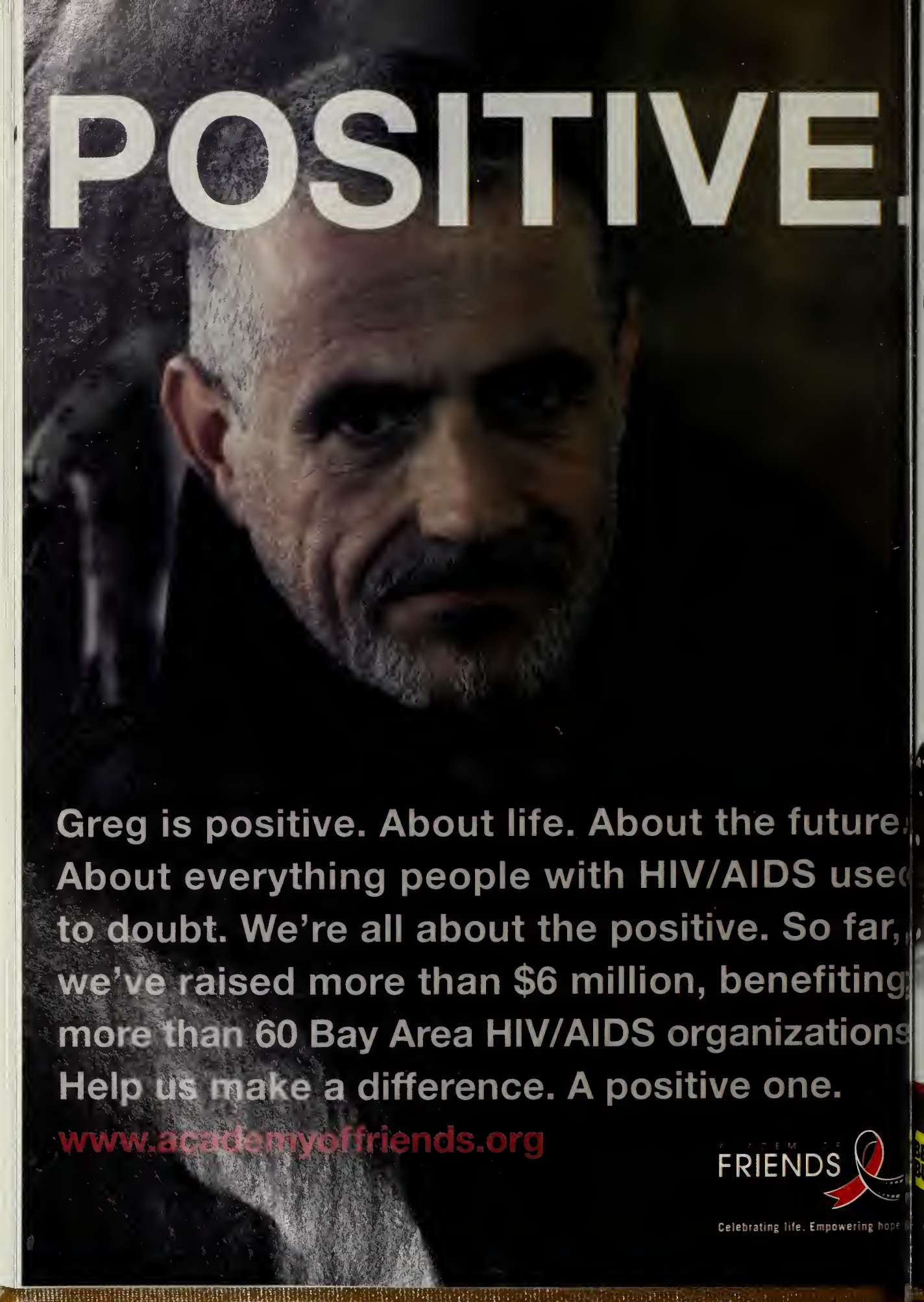
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BY JAMES C. COOPER

Why the Dollar's Decline Isn't a Downer

steep drop is unlikely, and there are advantages to a further slide

U.S. ECONOMY Back in 2002, billionaire investor George Soros boldly warned that the U.S. dollar's value could plunge by a third over the next few years. He was pretty much on target. Since the greenback's peak in early 2002, it has dropped 35% against the euro, 33% vs. a trade-weighted basket of major currencies, and 18% vs.

currencies of all countries the U.S. does business with. What's interesting is, nothing bad happened—except maybe for those investors who didn't sell the dollar short, as Mr. Soros presumably did. In fact, a lot of good things happened. U.S. companies became more competitive, and exports are now booming. Profits from overseas operations and returns on international investments are soaring as the gains translated back into dollars. Long-term interest rates are still low, stock prices are setting records, and the economy continues to grow at a moderate clip. But dollar worries are cropping up again. Through much of the fourth quarter, the greenback was undermined by perceptions in many areas of the foreign exchange markets that the U.S. economy is slowing down sharply enough to warrant the Federal Reserve to begin cutting interest rates sometime in 2007, and most analysts expect the dollar to continue to weaken at least gradually in the coming year.

The worst-case scenario would be a rapid decline that would disrupt global capital flows, damage foreign economies, push up U.S. inflation via higher import prices, and generally complicate the Fed's job in managing the economy and the financial markets. However, that seems unlikely. In fact, the potential pluses in a further downward drift in the greenback will most likely continue to outweigh any minuses—to the benefit of both investors and the economy.

THE DOLLAR WORRYWARTS point to the huge U.S. current account deficit. That gap, comprising mainly the trade deficit and some other financial transactions, ballooned to an annual rate of just over \$900 billion, or 3.8% of gross domestic product. At that level, the U.S. must attract some \$75 billion in foreign financing each month to manage its global indebtedness, and the borrowing requirement is almost certain to rise further in the coming year.

The latest concern is that prospects for U.S. economic growth and interest rates relative to those in the rest of the world are fading, making dollar-denominated investments less appealing by comparison. The U.S. will

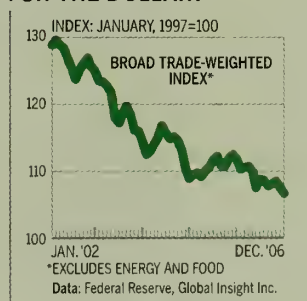
continue to attract the foreign financing it needs. The question is: at what level of the dollar? Since the dollar is the equilibrator between the funds the U.S. needs and the amount foreigners are willing to lend, market pressure on the greenback has been generally downward (chart).

The biggest danger in the coming year is a U.S. recession, but that still looks like a long shot. Currency markets began to fret at the end of last year that the housing recession would spill over to other areas of the economy, perhaps dragging down consumer spending. Worse-than-expected reports on home construction and weakness in manufacturing only fueled those concerns.

However, housing demand is firming up, and inventories of unsold homes are shrinking. Also, a broad effort by businesses to pare down top-heavy inventories of autos and home-related goods, which have sapped

the strength of the factory sector, is already running its course. Industrial activity in December picked up, based on the month's rise in the Purchasing Managers Index, to 51.4%, as compiled by the Institute for Supply Management. Also, consumer spending in the fourth quarter is shaping up to grow at

ANOTHER LEG DOWN FOR THE DOLLAR?



a healthy annual rate of about 4%. All this lessens the chances of any sharp or sustained economic weakness.

SO HOW MUCH MORE is the dollar likely to decline in 2007? Economists know short-term currency forecasting can be foolhardy in the rapid-fire world of financial globalization. But, while the dollar appears to be headed lower in coming months, it's important to note that it remains well supported by several forces that will limit the size and speed of the greenback's descent.

One interesting point: Since the currency has declined so much since 2002, it may already be undervalued.

Currency analysts at JPMorgan Chase estimate that, based on long-term influences, including country-by-country differences in productivity, prices, interest rates, and risk, the greenback is now about 10% undervalued. If so, that will be an important support in the coming year.

Of course, it's the short-term factors that move the currency markets. While they are pushing the dollar down right now, they are also supportive enough to alleviate worries about a dollar crash. For example, the current account deficit and its financing requirements are not likely to rise as rapidly this year as they did in 2006. Strong export growth is helping to stabilize the trade gap, and slower U.S. demand will cool the pace of imports. As a share of GDP, the deficit will look more stable this year.

ALSO, EVEN THOUGH differences in economic growth and interest rates between the U.S. and some of its trading partners are becoming relatively more favorable for investments in foreign economies, U.S. growth and rates of return are still at attractive levels. And they will stay that way as long as the economy remains strong.

That's especially true for the dollar vs. the Japanese yen. Short-term interest rates in Japan are still at zero, and analysts expect the Bank of Japan to tighten policy only gradually. The greenback will be somewhat more vulnerable against the euro, given that the European Central Bank will most likely continue to lift interest rates this year as the Fed takes a breather.

Other market forces are also pushing investors away from dollar-denominated assets. More U.S. investors are diversifying by looking abroad for higher returns. This

comes at a time when global liquidity continues to flow freely and the appetite for risk has not yet been stifled by stringent monetary policies. Also, analysts note that oil-exporting nations and some central banks are also diversifying their holdings away from dollars.

That is especially true for China, which is in the

process of reweighting its foreign-exchange reserves toward a greater mix of non-dollar currencies. That shift will allow the dollar to continue edging lower vs. the yuan, which began the year at about 7.8 yuan per dollar (chart). The dollar is down 3.3% from a year ago against the Chinese currency,

THE DOLLAR WILL FALL FURTHER VS. THE YUAN



and futures markets expect an additional 5% decline this year. This year's drop might even be larger than now expected. China's trade surplus ballooned in 2006, and more of its bulging forex reserves will find their way into non-dollar assets. Also, the U.S. continues to pressure China to speed up its revaluation process.

Don't look for much improvement in the U.S. trade gap with China, but a broadly more competitive dollar, combined with strong growth abroad, will continue to U.S. exports. In that sense, a lower dollar is an important step toward a rebalancing of global trade. ■

HOUSING

The Best Indicators of a Rebound

HAS THE HOME MARKET hit bottom? That is the key question for the U.S. economy in 2007. According to some housing indicators, there is some light at the end of the tunnel for homebuilders, but that cautious optimism comes with caveats.

To get the most reliable signal that the housing recession is over, keep an eye on the average monthly supply of new homes for sale and the average mortgage rate each quarter. Analysis by Goldman Sachs U.S. economist Edward McKelvey of eight pieces of housing data widely used as leading indicators of the housing cycle showed those two series are better than quarterly averages of

new and existing home sales, housing starts, mortgage applications, housing affordability, and homebuilder confidence.

In housing market upturns, all eight indicators do a good job of forecasting market peaks by two to five quarters. However, "a contraction is swifter and more cathartic," says McKelvey. That places a premium on indicators

that give a more consistent signal.

The monthly supply of homes—a ratio of new home inventories and home sales—has peaked one quarter before residential investment bottomed every time since 1961. Mortgage rates are nearly as consistent over that same period

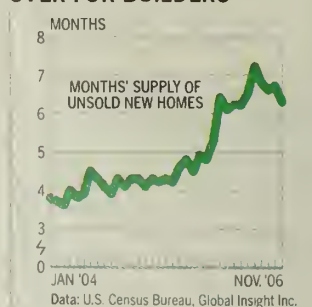
and have a similar lead time.

The supply of new homes for sale in the fourth quarter should decline at a November reading of 6.3 months, from 6.7 in October and the recent peak of 7.2 months last July. Mortgage rates also fell in both the third and fourth quarters of 2006.

But homebuilders are not out of the woods yet. The Census Bureau doesn't track cancellations, which stood around 7% of total sales contracts in 2006, vs. less than 4% in 2005, according to the National Association of Home Builders. As a result, reported sales are too high, inventories are too low, and change in the monthly supply may be skewed. Investors also expect the Federal Reserve to cut interest rates in 2007. If the Fed raises rates, or even stands pat, mortgage rates are likely to rise, putting more stress on builders. ■

—By James Mehring in New York

THE WORST COULD BE OVER FOR BUILDERS





**While Utah has
some lovely ski trails,
we go for
the airbags.**



IF YOU LOVE SKIING, CHANCES ARE YOU LOVE UTAH. And we love Utah too, but for a different reason. For us, it's the airbags. Toyota buys airbags from Autoliv in Ogden, Utah. They're terrific partners, one of our hundreds of quality suppliers across the country.

Relationships with suppliers are the lifeblood of our U.S. operations. At Toyota,

we purchase more than \$28 billion in U.S. parts, materials, goods, and services every year. And whether we are in North Carolina ordering engine sensors, in Michigan buying batteries, in Ohio getting steel, or in Utah picking up airbags, you can be sure of one thing: Toyota is committed to keeping our investment in America strong.

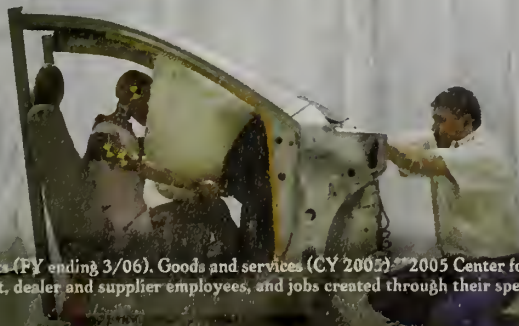
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The Business Week

News you need to know

EDITED BY MICHAEL ARNDT



Home Depot CEO No More With investors increasingly unhappy that CEO **Robert Nardelli** had earned more than \$120 million even as the retailer's stock stalled, **Home Depot** said on Jan. 3 that Nardelli had resigned by mutual consent. The new chief: **Frank Blake**, who joined in 2002. Nardelli's six-year reign had been fraught with controversy: While the retail giant's revenues had nearly doubled during Nardelli's tenure and the earnings per share had risen 140%, critics noted that its shares were trading at roughly the same level when Nardelli took over in 2000. Nardelli won't leave a pauper: The former GE exec got \$210 million in his departure deal.

See "Out at Home Depot," page 56

Is Steve's Job Safe? In a filing with the SEC on Dec. 29, **Apple Computer** claimed co-founder and CEO **Steve Jobs** was innocent of wrongdoing for any of the options shenanigans an internal probe revealed. The stock market breathed a sign of relief, but the intrigue may not be over.

See "Is Steve Jobs untouchable?" page 28

Work Hours at Wal-Mart Seeking to boost customer service, **Wal-Mart Stores** is adopting a new scheduling system that staffs U.S. outlets so more workers are on the floor during peak hours. The move comes as the world's largest retailer is struggling with weak sales and is expected to post its worst fourth-quarter profit growth in six years. **WakeUpWalMart.com**, a union group critical of the company's labor practices, contends the new

scheme will push out costlier full-time workers because they no longer have consistent schedules. Wal-Mart says it has no evidence that the number of full-time work will fall.

Back to Work at Goodyear The **United Steelworkers** and **Goodyear Tire & Rubber** disagree on many matters, but they have one thing in common: Both claim to be the winner in the three-month strike that ended on Jan. 2. More than 12,000 workers walked out last October after the company said it would close two plants. In the end, though, the company agreed to shutter just one and to put off the closure until the end of 2007. But by ending work at the 1,100-person plant in Texas, Goodyear claims it will save \$40 million over the three-year contract.

Putnam's New Parent? Ever since it was tarred in 2003 by federal and state allegations of improper trading, which it settled for \$110 million, **Putnam Investments** has struggled. Maybe a trip north of the border will do it good. The \$191 billion mutual fund unit of **Mars, Incorporated** is expected to fetch about \$3.9 billion from buyer **Power Corp. of Canada**. Neither Mars nor Power will confirm the sale, which should be wrapped up early this year, a person familiar with the deal says. Montreal-based Power owns Canadian mutual funds and wanted a foothold in the U.S. market.

A Suitor for Suez French retail and luxury tycoon **François Pinault** hinted on Jan. 2 that he might bid for Paris-based utility **Suez**. Based on the current Suez share price, Pinault would have to pay more than \$92 billion to take his prize. He might also face opposition from the French government, which has been trying to broker a merger between Suez and **Gaz de France**. Some investors want someone else to acquire Suez, though, and break up to get more money.

AT&T Rings In a Deal Ma Bell has grown a lot of sizes. **AT&T** completed its \$86 billion buy of **BellSouth** on Dec. 29 by agreeing to concessions friendly to rivals. AT&T promised federal regulators to maintain "network neutrality" of its high-speed Internet network for two years. AT&T will also offer DSL Internet access for \$19.95 a month and freeze some wholesale rates, agreeing to allow rivals access to its network for 48 months. The deal gives San Antonio-based AT&T full control of **Cingular Wireless**, which it plans to rename AT&T Wireless and bundle with other services.

ONLINE

"Wireline: Coming up in the wireline" www.businessweek.com/go/wireline

Nucor Acquires a Union Steelmaker **Nucor** has become the envy of the industry by spreading its award-winning egalitarian culture to its new mills, boosting productivity in the process. That may be harder at its latest addition. Using some of its cash stash, the company said on Jan.

as paying \$1.1 billion for **Harris Steel**, a Toronto steel manufacturer. In a first for Nucor, half of Harris' 3,000 workers are union members. Nucor CEO **Daniel DiMicco** says this is a good fit.

Littler Three Detroit limped out of 2006 with lower sales and market share, plus the prospect that **Toyota** would overtake both **General Motors** and **Ford** in worldwide sales by 2008 at the latest. In the U.S., GM sales were down 8.7%, while Ford was off 7.7%, and **Chrysler** 7%, according to Autodata. Toyota's U.S. sales, meantime, rose 12.5%. **Lexus** was the top luxury brand. **BMW** was second. As carmakers head to the North American International Auto Show in Detroit, we will see yet another sign of the times: **Chang Feng** will be the first Chinese company to display cars.

Golden Exit at Penney Leave this one off the résumé: **Penney** fired Chief Operating Officer **Catherine West** on Jan. 28 after just five months on the job. The former U.S. credit-card head at **Capital One Financial** had failed to learn quickly enough the operational skills required in running a retail store, says one Penney insider. West, 47, could not be reached for comment. As a consolation, she'll reap a severance package of nearly \$10 million.

EarthLink's CEO Internet service provider **EarthLink** announced on Jan. 3 that CEO **Charles "Garry" Betty**, 49, had died of complications from cancer. Betty, who had been with EarthLink since 1996, helped the Atlanta company boost its subscriber base to 5 million, a tenfold increase. EarthLink said **Michael Lunsford**, who became interim CEO in November, would stay on.

Resolved: No Trans Fats in 2007

Even if they could only do something about calories. On Jan. 3, **Starbucks** quit using trans fats in the pastries it serves in half of its 5,600 company-owned outlets in the U.S., including outlets in Chicago, Los Angeles, New York, Philadelphia, and Washington. The switch away from trans fats, also known as partially hydrogenated oils, came as the nation's restaurants are rewriting their recipes to comply with a ban that New York City will begin imposing next July. **KFC** will convert to a healthier frying oil at all its 5,500 U.S. locations by July, and in field tests, **McDonald's** and **Burger King** are trying out oils without trans fats, which have been linked to heart disease. But the cooking oil change won't help dieters meet their New Year's resolutions. Starbucks chocolate chunk scone still packs 510 calories and six grams of saturated fat.

ONLINE See "How KFC went trans-fat free," www.businessweek.com/go/tbw



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THE TEFLON FACTOR

IS STEVE JOBS UNTOUCHABLE?

An internal inquiry gives him a pass in Apple's backdating scandal—but raises questions about whether he's getting special treatment

BY PETER BURROWS

IN SILICON VALLEY, STEVE JOBS IS admired for many things: his storybook resuscitation of Apple Computer Inc., his billion-dollar-plus fortune, his rock star status as the driving force behind iconic products such as the iPod. Near the top of the list is Jobs's famed ability to spin what admiring techies refer to as a "reality distortion field" to win consumers over to the Apple view of the world.

But will it work with government regulators? As Jobs prepares to wow the masses once again with his keynote at the annual Macworld trade show on Jan. 9, skepticism abounds among options experts, as well as techies, that the Apple chief executive is totally in the clear over his role in resetting start dates for company stock options. A report issued on Dec. 29 by a two-member special committee, composed of no less than former Vice-President Al Gore and tough-minded finance veteran Jerome B. York, "found no misconduct" by Jobs or other managers. Yet it acknowledged that he knew about some of the 6,428 option grants handed out between late

1996 and early 2003—roughly 15% of the total in that time—that were improperly dated to give employees an artificially low price. On some occasions, Jobs even recommended the dates.

MASTER MARKETER

THE SECURITIES & Exchange Commission is scrutinizing Apple's internal audit as part of a formal investigation into the company's backdating. Moreover, several legal and pay experts wonder at what seems to be a different standard in how Apple is dealing with its most valuable employee when other CEOs are being pushed out for similar or less obvious involvement in backdating. Says managing director Alan Johnson of Johnson Associates, a compensation consulting firm in New York: "He knew what he was doing. It wasn't 'the dog ate it.' He backdated the options on purpose and the committee said it will give him a free pass." Even some Valley companies are troubled by the conclusions reached in the Apple report. "It looks like Apple's board is trying to whitewash the situation because they like him so much," says Willem P.

Roelandts, CEO of chipmaker Xilinx.

But is the world ready to see one of its greatest innovators sacrificed at the altar of the good-governance gods—especially when it's not clear how he enriched or his shareholders damaged? The backdating scandal has been rattling along for months now, claiming numerous high-profile victims such as United Health Group CEO Dr. Will W. McGuire, who retired in December. The involvement of Jobs, though, raises the stakes to a whole new level.

No big company has more of its success wrapped up in one person than Jobs is. A master marketer whose years of experience have sharpened his skill at creating stylish, breakthrough products, he combines not just hardware and software smarts but a sense of timing for how all that technology must be packaged together with the music, movies, and other content consumers want. He proved that in his stewardship of Pixar Animation Studios Inc. before it was sold to Walt Disney & Co. a year ago, and in forging agreements with other tech companies and Hollywood



dios to create the iTunes marketplace. The reward for shareholders: Apple's stock price has climbed 1,025% since Jan. 1, 2001, just before the iPod era began, to a total market value of \$72 billion.

That's why few expect Apple's board to push Jobs out even if the government does move against him. Some suggest that it would hang tough with him even if criminal charges were filed by the Justice Dept., which is a remote possibility for many reasons. So far, the government has found sufficient grounds to indict only five executives on backdating out of all those at the 200-plus companies involved in the scandal. It's not easy to prove that an executive intended to deceive shareholders rather than just engaged in sloppy paperwork, say lawyers. And there would be hell to pay for going after Jobs given the damage that could be done to Apple's investors, customers, and business partners. Says Harvard Business School management professor David B. Yoffie: "Obviously, these are inappropriate activities that anyone should be ashamed of. But it wouldn't be in shareholders' best interests to have Steve Jobs leave for something that happened four years ago that didn't have a material impact on their holdings."

TWO RESIGNATIONS

JUST LOOK AT the numbers. The total financial hit to shareholders announced by Apple—some \$84 million in noncash expenses—is negligible given Apple's size. On the other hand, Apple's stock price plunged 5% at the start of trading on Dec. 27 after a legal publication, *The Recorder*, said Jobs had hired a lawyer to represent him in the investigation. Over the next few hours, buyers rushed in on the belief the market had overreacted and bid the stock right back up. Two mornings later, the stock jumped another 5% when Apple's special committee of directors vouched for Jobs and declared the options problem corrected. Just in those 48 hours of trading, keeping Jobs on as CEO was shown to be worth at least 9% of the value of Apple. And his true value is probably much higher. Analyst Gene Munster of Piper Jaffray Cos. estimates if Jobs were ousted, Apple's stock would take an immediate hit of up to 20%, roughly \$14 billion, and continue south as investors considered the longer-term implications.

Even for Jobs's staunchest defenders, though, the

Apple board's latest disclosures raise troubling questions. For example, what role did Jobs have in approving

a 10 million-share grant to him that was finalized on Jan. 18, 2000, but priced as of Jan. 12, when Apple shares were trading 19% lower? Apple also admitted that 7.5 million options granted to Jobs in 2001 were priced at a board meeting that never took place. But the company didn't say how that meeting came to exist in Apple's books, or how it is possible that Jobs, also chairman of Apple's board, wouldn't have known about that move.

If the point of launching a special committee investigation is to convince regulators that you've closely examined any irregularities and dealt with any problems, "I just don't think the Apple report is going to do that," says James L. Sanders, a former SEC attorney now with the law firm of McDermott, Will & Emery. Apple officials would not comment for this story beyond their public filings.

Some lawyers say government investigators may be troubled that Jobs's role in the backdating has appeared to grow with each of the four filings since Apple first reported last June, and could cause them to question the reliability of Apple's findings. "One of the factors the SEC looks to is [whether there is] full and complete public disclosure, not the dance of the seven veils," says one highly regarded securities lawyer. Then there's Jobs's tenure as a director at Pixar, where Disney is now looking at a number of grants.

Also, Apple's committee report suggests that two former executives were somehow culpable for the backdating. While Apple doesn't name names, many observers take that to mean former Chief Financial Officer Fred Anderson, who resigned from Apple's board on Sept. 30, and former general counsel Nancy Heinen, who abruptly left the company in May. Her attorney, Cris Arguedas, says Heinen does not know if she's one of the duo implicated by Apple, but defends her character. A source close to Anderson

JOBS His role in the backdating is larger than Apple initially reported last summer



Different Treatment?

Both Apple and McAfee were found to have misstated options earnings, yet their CEOs' fates were far from identical.

WHAT THE COMPANY FOUND

APPLE On Dec. 29, the board announced that 6,428 options had been improperly altered between 1997 and 2003, and Steve Jobs was aware [of] or recommended the selection of favorable grant dates." Apple restated earnings by \$84 mil

McAfee On Oct. 11, the security software outfit announced restate earnings by \$100 million-plus in options-related exp with no mention of a direct role by CEO George Samenuk.



confirms that he dropped his board seat after learning that he might be a target of the board's investigation. But his lawyer says Anderson had no day-to-day role in options administration.

Apple's treatment of Jobs stands in stark contrast to what has happened at other companies caught up in the backdating scandal. In most cases where executives were found to have a role in backdating, they left.

Take security software maker McAfee Inc. On Oct. 11, a special committee to the board announced the retirement of CEO George Samenuk. On the same day, the committee said McAfee would incur \$100 million-plus in expenses that should have been paid on backdated options, as required by accounting rules at the time. The company's press release hinted that Samenuk's only transgression was providing insufficient oversight. He was quoted in the statement as saying: "I regret that some of the stock option problems identified by the special committee occurred on my watch."

TALENT LURE

IN ITS REPORT, Apple suggests that one reason Jobs tolerated backdating is that he didn't understand basic options accounting, particularly the pre-Sarbanes-Oxley need to expense any option carrying a price other than that established on the date it was made final. It may beg credulity that such a powerful executive is such an accounting novice, but many techies say they paid little attention to those details during the boom years. Options were a way to lure talent, and they left the details to auditors and lawyers. Says one Valley CEO: "Today's perspective is being applied to something that was an industry practice. We were all fighting to find and keep great people."

But now that backdating is front and center, it's clear that Jobs-led companies were knee-deep in it. On numerous occasions since 1997, top lieutenants at Apple and Pixar received options priced on days when the stock was at monthly, or in Pixar's case, near-

yearly lows. That includes the 10 million-share grant to Jobs in early 2000, which came just after a 22% nine-day plunge in Apple's stock price and preceded a subsequent 30% increase in the eight days

that followed. "I'm not saying it was backdated and I'm not saying they did anything illegal, but [the circumstances are] consistent with manipulation," says University of Iowa finance professor Erik Lie (page 64), whose research helped ignite the options scandal.

Jobs never directly cashed in on those options, or those from another big grant in 2001, because Apple's share price fell below the strike price. But in 2003, Apple's board swapped the

"underwater" options for 5 million restricted shares of stock with a value of \$75 million. For some, that raises the question whether Apple pegged the stock grant to the backdated value of the options, and whether Jobs, as the special committee maintains, "did not receive or financially benefit from these grants."

If Jobs ever does step down, there's no obvious replacement, compounding the risk for Apple shareholders. More than likely, Chief Operating Officer Timothy D. Cook would take the helm; that's what happened when Jobs took six weeks off in 2004 to undergo successful cancer surgery. But while Cook is a respected operations wonk, he lacks Jobs's charisma, leadership, and gut for tech trends, say analysts.

Some legal experts say Apple missed an opportunity when the board committee issued its report. Rather than absolve Jobs of all blame, it should have admitted he'd made a mistake that was common during the excesses of the boom and agree to have Apple employees, including Jobs, reimburse investors for any losses.

Now all Apple's shareholders can do is hope that regulators prove as forgiving as the board. Says former SEC Commissioner Joseph A. Grundfest, a professor at Stanford Law School: "Steve Jobs is a national treasure, and Apple has to do everything it can to keep him actively engaged. If Martha Stewart can stay at her company, there should be no issue—even in the worst case—in designing a structure that keeps Steve Jobs at Apple." ■

—With Lorraine Woellert in Washington and Arik Hesseldahl in New York

THE STAT

20%

Estimate for the immediate drop in Apple's share price if Steve Jobs were ousted. That would come to just over \$14 billion.

Data: Piper Jaffray Cos. analyst Gene Munster

THE COMPANY DID

vo-person special board committee found "no by current management," and said Jobs "did not nancially benefit from these grants or appreciate the implications."

IO Samenuk retired, saying "I regret that some of the problems identified by the special committee occurred h."



RETAILING

SOMEONE'S BEEN USING MY GIFT CARD

The cards are more popular than ever, but more tales of fraud are making the rounds

BY ELIZABETH WOYKE

SUSAN LEIBOWITZ FIGURED she had found the ideal present for a retiring co-worker moving cross-country—a \$615 gift card from Target. Not only did her friend adore shopping at the retailer, but she was relocating to a city with a Target store (Roanoke, Va.) and could use the gift to decorate

her new house when and how she liked. Plus, giving it was easy. Leibowitz, a Los Angeles-based network news producer, collected money from her colleagues and bought the card in a few minutes at a West Hollywood Target. But a week later, her satisfaction turned to horror when her friend called to report: “The money’s gone!” She had tried to redeem the card and found it drained of value.

In the biggest year for gift cards ever,

with annual sales rising to \$53 billion, according to researchers Mercator Advisory Group, buyers and receivers learning the pitfalls of the popular prepaid cards issued by retailers. Local police departments and Better Business Bureaus say crooks are adapting techniques used in identity theft and credit card fraud to mine vulnerabilities in the gift-card system.

INSIDE ACCESS

SCHEMES GENERALLY fall into three basic types: stealing (such as bar codes and magnetic strip information, planting cards and indulging in checkout scenarios (generally the work of employees with access to both the cards and the systems that activate or deactivate them). Companies participated in the 2005 National Retail Security Survey, conducted by the University of Florida’s Center for Studies in Criminology & Justice, estimate that employees are responsible for 62% of gift-card fraud, while stolen and counterfeit cards account for 13% each.

One way to steal money from gift cards is to copy data off sold cards, then use the stolen Web site or 800 number to check their status. Once the cards are bought and loaded with dollars, crooks use the data to buy goods online or to create bogus cards. Other fraudsters clone cards they own and plant the copies in stores to be sold. When the cards are activated, the money goes onto the thieves’ cards.

The easiest scams take insider knowledge or access and exploit it. Employees may pretend a card is empty or deactivated and persuade a customer to hand over the “worthless” card, hoping to use it later. They may just swap them, pocketing activated cards at the register while slipping customers look-alikes. Or they may clone cards using information off discarded receipts.

Gift cards also get tied up in other types of fraud. Some thieves steal credit cards, then quickly buy up prepaid cards and sell them on auction Web sites for money. PlasticJungle.com, a gift-exchange site, was hit by this scam a few weeks ago, leading to a new rule: Customers can only sell cards that are at least 10 days old, says CEO Tina Henson.

Leibowitz suspects someone gave

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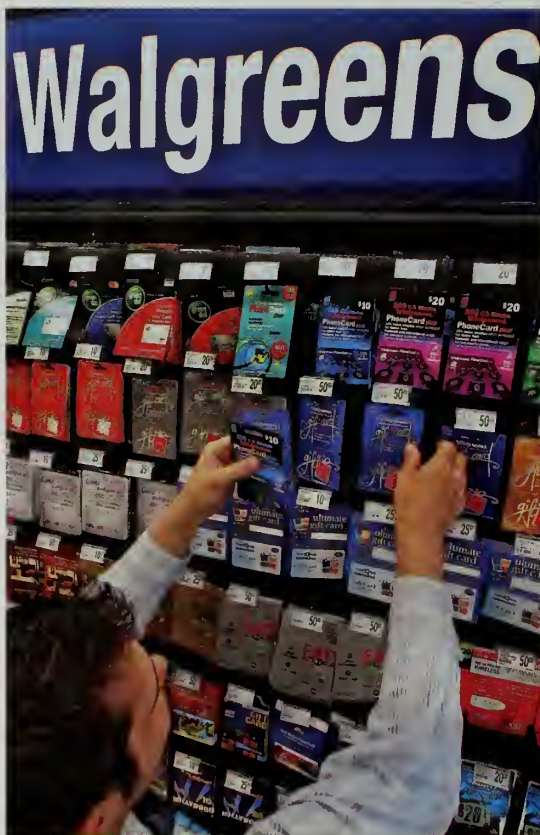
access to her friend's gift card using a duplicate receipt. (She recalls that the Target clerk printed a second receipt, saying the first one hadn't printed correctly. Receipts usually show a card's value and number in full.) After alerting a store manager, Target media relations, and its in-house "research team," Leibowitz found the card had been taken to an Inglewood (Calif.) store where it had been used to finance a stranger's shopping spree. Within a day, she had a replacement card. "Initially, people weren't that helpful, but we did get our money back quickly," she says. Target declined to comment on a particular case, but said in a statement: "We have extensive procedures in place to foil fraudulent activity of gift cards [and] are investigating this isolated incident and will take appropriate action."

FOUND MONEY

STORIES LIKE LEIBOWITZ' vex retailers even though they say the cost of investigating and refunding gift-card claims is minimal vs. the losses from merchandise theft and credit-card fraud. What scares them is customers' perception of the risk. Retailers love gift cards, crediting them with everything from luring hard-to-reach first-time shoppers to building brand loyalty. Gift-card owners also tend to be less price-sensitive. According to Daniel R. Horne, a Providence College marketing professor, cardholders, buoyed by a sense of "found money," spend an average of 1.4 times the amount on their cards.

Retailers usually lump gift-card losses in with other kinds of fraud and theft, so it's difficult to calculate the total amount of gift-card theft. In the latest *National Retail Security Survey*, 75 companies that track gift-card fraud say they lost an average of \$72,000 in 2005.

Some cases never come to their atten-



tion because people are too embarrassed or busy to pursue claims. That's the situation with Kimberly Eberl, a 29-year-old public-relations consultant, who bought a \$25 Quizno's gift card as a last-minute Christmas gift for her uncle in Cincinnati. When he tried to use it a day later, the card came up empty. Eberl, who lives in Chicago, says: "I'm annoyed, but I'm not going to go all the way back to Ohio to prove or disprove what happened."

Scam stories are plentiful on the Internet, where they first popped up a few years ago. They were given new life in

SITTING DUCKS? Cards not placed behind the counter more vulnerable to fraud

November, when the Jack County (Ore.) sheriff's department issued an e-mail "fraud alert" about gift cards. Detective Sergeant Colin Fagan wrote the bulletin after a local woman confessed to stealing thousands of dollars in cards and trading the credit to a methamphetamine dealer for drugs. The notice became a viral sensation, prompting law enforcement and consumer protection agencies to issue their own warnings as retailers rushed to reassure customers.

Retailers say shoppers have ample safeguards. Bob Skidmore, executive vice-president of Comdata, which processes about half of all gift cards, estimates 95% have a security code that customers must enter when using the cards online or checking balances. This year, Macy's and Blooming-

dale's added codes covered with scratch-off coatings. Sears, Kmart, CVS, Circuit City and others have similar features. Home Depot customers can only check balances in person at the stores.

Manufacturers also are devising fraud-resistant designs and packaging. Bloomingdale's cards come in chiseled cases that double as gift boxes. Cards operated by major credit-card providers like Visa International's "Vanilla" cards have embossed account numbers and are enclosed in cardboard envelopes.

Technology can deter thieves,

The ABCs Of Gift-Card Safety

Consumers can guard against gift-card fraud with a few small steps.

- Ask the cashier to give you a card that is not on display but kept behind the counter. They're less likely to have been tampered with.
- Look for gift cards with concealed security codes or protective sleeves. Check both sides of the card for signs of tampering.
- Immediately after purchasing the card, ask the cashier to test it and show you the

balance. Make sure it matches the balance listed on the receipt.

- Save the original receipt or give it to the recipient. Many retailers will replace drained cards if you can show proof of purchase.

- Register cards on store Web sites, if possible. That can make it easier to replace



the card in case of fraud.

- Use caution when buying gift cards from online auction sites. There's often no way to ensure that the cards are valid and have the listed value.

Data: Retailers, National Retail Federation, Better Business Bureau, Federal Trade Commission

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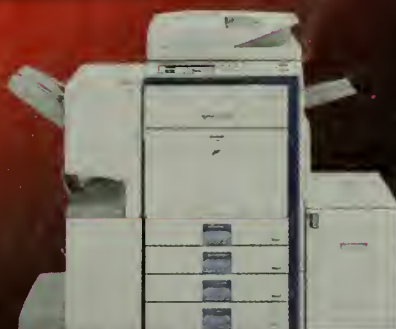


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Comdata's system highlights particularly prolific users (say, 10 calls in 30 days or inquiries on five cards from the same computer) in "exception reports," which retailers can use to block access. Borders Books requires users to register credit cards when redeeming gift codes online, theorizing that fraudsters won't want to leave identifying information.

The real question for most retailers is whether all the hype surrounding gift-card scams dealt sales a blow during the crucial holiday season, when one-third of annual card sales typically occur. "It was still a really good year," says Providence College's Horne. (Holiday sales this year were up 34%, to \$25 billion, estimates the National Retail Federa-

tion.) "But people in the industry probably wondering how good a year could have been." ■

—With Sonja Ryst in New York

BusinessWeek weekend For more on what consumers can do to avoid gift-card scams, watch a weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com.



TAKE IT BACK The return line at a New Jersey Target

OUTSOURCING

What Happens to That Scarf You Really Hated

Hard as it might be for Aunt Betty to imagine, all you wanted for Christmas was not, in fact, a purple rhinestone-studded leather iPod case.

As Americans rub the holiday haze from their eyes and peruse their well-meant but unwanted loot in the harsher January light, they'll enact in force the first retail ritual of each new year: bringing it back to the store.

Shoppers, on average, return about 6% of everything they buy. That proportion spikes in January to nearly 10%. This used to be a sore point for retailers. Rather than try to make sense of a hodgepodge of generally used, sometimes broken goods with packaging shredded or instructions missing, stores tended just to write the lot off as a loss. But over the past decade, an opportunistic industry has sprung up to give the reject pile a new lease on life.

Most big-box retailers—Sears, Target, Best Buy, Kohl's, and many others—now outsource the handling of returns to companies that specialize in so-called reverse logistics. These third parties' job, basically, is to pick up a store's returns and

figure out what to do with them—restock an item, sell it somewhere else, like in Peru or at a flea market, or throw it in the trash.

For retailers, it's a way to squeeze money from what previously was a cost center, since they get a cut of any eventual sales. Genco, the biggest such service provider, charges stores a management fee to collect and sort the products at its 33 return centers. If it's able to sell a returned item to a secondary market, the proceeds are split with the retailer. Newgistics, an Austin (Tex.) company, handles returns specifically for online sales—where return rates can

surge up to 20%—for Amazon.com, J. Crew, and Nordstrom, among others, charging by package. Other companies, such as Liquidity Services, don't charge a fee, only taking a cut from auctions of goods.

The best gift you can give a returns processor is to bring back something for no other reason than you just changed your mind. If

that item gets back to a Genco center, for example, the manufacturer may give the retailer a credit for the return (free money). Then Genco will send the defect-free, originally wrapped product back to the retailer to be sold again (more money).

Stores are more willing to put unmolested goods back on the shelf. In the most common scenario, though, shoppers return something and simply say: "It broke," says Genco Executive Vice-President Curtis Greve. "That tells you how reliable reasons for returns are." It also suggests why retail chains are more than happy to pay someone else to make sense of them. Pittsburgh-based, privately held Genco helped develop this niche in 1993 when, as a \$34 million-a-year company, it started handling returns for Wal-Mart Stores Inc. By 2006, Genco had \$570 million in revenue. Now it does logistics work for more than 100 clients (though not Wal-Mart, which licensed Genco's software and runs the process itself).

The trick for logistics companies is to find other places for returned merchandise. Much of what Genco sells goes to closeout retailers or dollar stores. If something is defective, it goes back to the manufacturer, or if that's not possible, Genco will try to fix it. It even puts products up on eBay. Each retailer has its own restrictions about its returned goods' eventual home. About 40% of Genco's \$1 billion in turnover comes from goods it sells in secondary markets overseas, Greve says. Some retailers require Genco to scrub the product of logos; some just want the highest bid.

As retailers get savvier about wringing money from returns, they're working harder to stem the inexorable march to the service desk altogether. With the proliferation of gift cards, post-holiday return volume isn't growing the way it used to. And when shopping for themselves, people more often buy things they'll like the first time around.

—By Brian Hinde

THE STAT

6%

The amount of all merchandise sold that gets returned

Data: University of Nevada Center for Logistics Management

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BIDDING WARS

BANKRUPTCY BECOMES DELPHI

It has attracted two bidders with starkly different approaches

BY DAVID WELCH

NEED MORE EVIDENCE that private investment firms are on the prowl for risky buyouts? Consider the swirl of activity surrounding bankrupt Delphi Corp. Despite problems that would scare off even the most courageous investor in ordinary times—high labor costs, a contentious union, billions in retiree obligations, and a heavy reliance on ever-shrinking General Motors Corp., to name a few—the auto parts maker has attracted bids from two groups of private investors, one as high as \$4.7 billion.

A multibillion-dollar bidding war over a bankrupt company is unusual enough. But one of the offers also includes a provision that would give current Delphi shareholders a major voice in the reorganized company. “Shareholder control in Chapter 11 cases is very rare,” says William J. Rochelle III, a bankruptcy attorney with Fullbright & Jaworski in New York. “We’re exploring the outer limits of the solar system with this.”

Delphi isn’t your typical company in bankruptcy. In about 96% of bankruptcy cases, companies’ share prices are at or near zero. Shareholders usually dump their stock because bondholders and lenders have stronger claims on the remaining assets. But Delphi fetches nearly \$4 a share, having soared in the past year; its \$2.1 billion in shareholder equity can’t be ignored. There’s another wild card at Delphi: The United Auto Workers



has the power to effectively scuttle any deal it finds unsatisfactory. All of that makes the bankruptcy judge’s decision tricky. Delphi declined to comment.

The battle for Delphi heated up on Dec. 18 when Chatham (N.J.)-based hedge fund Appaloosa Management, the company’s biggest shareholder, proposed to invest \$3.4 billion and reorganize the company. Four days later, Dallas-based investment firm Highland Capital, the second-biggest shareholder, bid \$4.7 billion.

Appaloosa seems to be in the driver’s seat. Along with partners Cerberus Capital Management, Harbinger Capital Partners, and a few others, it already has agreed with Delphi management and the company’s former parent, GM, to inject cash and restructure ownership. The investment hinges on a deal that sticks GM with billions in union retiree benefits. (GM has subsidized buyouts for 20,000 Delphi workers, will rehire up to 5,000

workers, and will assume up to \$7.5 billion in retiree obligations.) The proposal would give 5% of Delphi’s stock to GM and more to unsecured creditors, all of which would come from the hides of shareholders. Appaloosa and Cerberus would appoint 6 of the 12 board seats and own 30% to 72% of Delphi. Appaloosa declined to comment.

By contrast, Highland’s deal would give shareholders with at least 0.5% of outstanding shares a chance to keep their full stake in the new company, an unusual result in a bankruptcy reorganization. And only 2 of the 12 board seats would come from management, the rest being independent. “Once we saw [Appaloosa’s] proposal, we knew we could live with it,” says Patrick Daugherty, a senior partner at Highland.

Highland’s offer seems a no-brainer for any judge charged with finding the best resolution for all involved parties. It’s rich with better provisions for shareholders. “It’s difficult for a judge to say no to the person who has the money is on the table,” says law professor Ly M. LoPucki of the University of California at Los Angeles School of Law.

But Highland faces a uphill battle. Appaloosa boss David Tepper has spent months working with GM and Delphi on the proposal. He has also forged a relationship with the UAW, visiting the union’s Detroit headquarters several times. Highland has no such relationship. And the UAW, which is negotiating a new labor deal with Delphi, might balk at any buyout its leaders don’t like a potential owner. In fact, to appease the UAW, which has a contentious relationship with Delphi chairman and CEO, turnaround specialist Robert S. “Steve” Miller, Appaloosa insisted that Miller step down at completion of the bankruptcy.

So why did Highland bother at all? Even if the bid fails, the firm might succeed in other ways. Its presence could force Appaloosa and its partners to sweeten their proposal or to make a deal more shareholder-friendly, either of which would benefit Highland with its current 7.9% stake in Delphi. That wouldn’t be a bad result for taking a bite out of a bankrupt company. ■

DELPHI FACTORY

The company’s stock still fetches nearly \$4 a share

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Departures					Arrivals				
CITY	FLIGHT NO	TIME	GATE	STATUS	CITY	FLIGHT NO	TIME	GATE	STATUS
TOKYO	2195	6:25	A11	ON TIME	MANILA	715	6:11	B12	ON TIME
SHANGHAI	2272	6:50	B10	ON TIME	ISTANBUL	216	6:11	A11	ON TIME
HONG KONG	756	6:55	E25	ON TIME	MOSCOW	222	6:10	C20	ON TIME
MEXICO CITY	701	7:50	D9	ON TIME	BANGKOK	1075	7:45	A4	ON TIME
SAO PAULO	717	7:55	A8	ON TIME	MADRID	2072	7:15	B2	ON TIME
BUENOS AIRES	727	8:00	C16	ON TIME	FRANKFURT	712	8:10	A11	ON TIME
CAIRO	765	8:55	B1	ON TIME	SYDNEY	729	8:50	B10	ON TIME
DUBLIN	2123	9:0	A7	ON TIME	SINGAPORE	2190	9:00	C17	ON TIME
LONDON	201	9:03	A2	ON TIME	TAIPEI	716	9:15	B3	ON TIME
ZURICH	726	9:45	C8	ON TIME	KUALA LUMPUR	725	9:55	B18	ON TIME
ROME	516	10:15	E17	ON TIME	DUBAI	271	10:30	A9	ON TIME
PARIS	2191	10:40	B13	ON TIME	BEIJING	2623	10:50	A16	ON TIME
COPENHAGEN	227	12:05	B18	ON TIME	HAMBURG	62	12:00	C25	ON TIME
NEW YORK CITY	812	12:50	A9	ON TIME	MELBOURNE	725	12:45	C9	ON TIME
SAN FRANCISCO	611	1:05	A16	ON TIME	GENEVA	712	1:08	A8	ON TIME
VANCOUVER	2112	1:30	B12	ON TIME	STOCKHOLM	501	1:45	C16	ON TIME
TORONTO	1872	1:45	C23	ON TIME	ST. PETERSBURG	753	1:55	B1	ON TIME
SINGAPORE	252	2:02	C20	ON TIME	OSAKA	2372	1:30	A7	ON TIME
DELHI	515	2:15	A4	ON TIME	MUMBAI	2193	2:55	A2	ON TIME
ATHENS	711	3:00	B2	ON TIME	SEOUL	2102	3:15	C8	ON TIME

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THE FIZZ BIZ

A SLICK PITCH FOR
'NEGATIVE CALORIES'

Coke and Nestlé use the buzzwords of weight loss while avoiding health claims

BY BURT HELM

THE GIANT BILLBOARD in Midtown Manhattan is simple and direct: "Burning calories is not just officially delicious." Below this statement stands a can of carbonated tea called Enviga, jointly marketed by Coca-Cola Co. and Nestlé. The two companies say clinical research shows that the new caffeinated drink is not just low calorie or even zero calorie but "negative calorie."

Leaving aside "officially delicious," what exactly is a negative calorie? The back of each \$1.45 can explains that by drinking three 12-oz. Envigas a day—each just 5 calories—healthy adults of normal weight between the ages of 18 and 35 will burn 60-100 calories more per day than they would otherwise.

This assertion has a lot of scientists scratching their heads. Consuming caffeinated drinks speeds up metabolism, causing the drinker to burn calories. That's nothing new. But as New York University nutrition professor Marion Nestle (no relation to the company) points out, burning an extra 100 calories a day won't do much for weight or health.

In any case, why would drinking three cans of Enviga have a bigger impact than gulping equal amounts of other caffeinated, sugar-free drinks? The answer, say Enviga's makers, lies in an extract of green tea known as EGCG, which amplifies the effect of the 100 milligrams of caffeine per can (about the same as a cup of coffee) without sending the drinker off on a teeth-chattering jag.

By way of proof, Coke's chief scientist, Rhona S. Applebaum, points to two small trials involv-

ing EGCG and one short study of Enviga. In the latter, over the course of 72 hours, a few dozen test subjects burned more calories on Enviga than they did when drinking an Enviga-like placebo.

Whether or not the science measures up, experts in health-food marketing say the two companies have staged a clever high-wire act. Obese Americans are bound to notice Enviga—they can hardly miss the ads, which go national in February. Yet nowhere in the literature do the two partners promote the product specifically as a weight-loss brew. So both the ingredient dosages and carefully worded health claims should land just below the radar of regulators who would take action if they spot bogus health claims. And though one watchdog group has threatened to sue over false advertising, the companies say the claims for the drink are justified.

Amidst tepid sales of carbonated sodas and

Careful wording aims to fly under the radar of regulators, but one watchdog group has threatened to sue

fruit drinks, both Coke and Nestlé have been searching for new markets. Botanical teas and nutrient-enhanced drinks present tasty opportunities. Sales of the former have been growing steadily. And nutrient drinks have shot up more than 240% over the past five years, topping \$1 billion at wholesale in 2006, according to researcher Beverage Marketing Corp.

Nestlé spotted this trend a few years ago. In 2002 its management team moved in on nutrition science pertaining to diabetes and weight loss. Nestlé funded some of the primary studies on EGCG in green tea, leading to Enviga. Such products also made sense to Coke, which owns health brands such as Odwalla, a vitamin-enriched Minute Maid orange juice, and is a long-time Nestlé partner. Beverage Marketing Managing Director Gary A. Hemphill says the two are pushing the frontier in the health-and-wellness category. Health drinks that "burn calories" are something untried and underdeveloped right now," he says.

The Center for Science in the Public Interest, a watchdog group, bristles at the way Enviga is positioned. On December 11 it threatened to sue Coca-Cola and Nestlé for marketing a weight-loss product whose claims can't be substantiated. Manufacturers say the drink isn't aimed

at overweight consumers, "but look at the buzzwords," says Michael F. Jacobson, the center's executive director. "Why would someone want 'negative calories' other than for losing weight?"

John Hackett, Coca-Cola's senior marketing vice president for North America, insists it's not about weight loss. "We all but admit Enviga's impact is mostly psychological. 'The line of this campaign is 'Think Positive, Don't Be Negative,'" he explains, adding that Enviga should stimulate fresh ideas about how to burn calories. "It doesn't replace exercise or healthy eating. And nutritionists don't think it does nothing." "It sounds like they're not going to be consumers of this product," Hackett says.



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GLOBAL EQUITIES

EMERGING
PITFALLS?

Sizzling markets in developing countries look even riskier

BY ROBEN FARZAD

SOMEWHERE IN THE Communist afterlife, Lenin opens his morning *Pravda* to learn the Russian stock market has jumped by almost 3,000% in the past eight years. Down the hall, Mao Zedong spills his green tea upon hearing of the Shanghai exchange's 130% surge in 2006 and the world-record \$22 billion initial public offering for Industrial & Commercial Bank of China. Ho Chi Minh, meanwhile, recoils in horror (though he still yearns for a CNBC feed) after reading that Vietnam's stock index more than doubled in 2006.

The comrades might well shudder, but today's capitalists sure like the Communists' old haunts. Since 2003, stocks in developing economies have averaged gains of 30% annually, blowing away shares from less exotic locales. With the Mexican, Asian, and Russian meltdowns of the 1990s long forgotten, developing-

country stocks keep jumping to all-time highs. Over the past five years, emerging-markets mutual funds have delivered four times the average annual returns of diversified U.S. stock funds, according to investment research firm Lipper Inc.

'SEMI-GENUINE EXCITEMENT'

AND FOR GOOD REASON. Developing markets, historically the province of hyperinflation and parliamentary donnybrooks, now enjoy brimming surpluses, thanks to record commodity prices and newfound fiscal discipline. Since 2001 these economies have posted three times the average annual per-capita economic growth of their developed counterparts and now represent a quarter of global output. Stocks in emerging markets are "the last bit of semi-genuine excitement in the business," says Jeremy Grantham, the famously cautious chairman of GMO, a \$127 billion investment management firm in Boston.

Too much excitement, though, invites peril. Emerging markets have undeniably changed in the past decade, but lately they're looking overextended—so any hiccup could send them tumbling. And while the potential triggers for a fall have changed, they're still there. As economies in the developing world get stronger, governments are getting more assertive and meddling with both companies and neighboring countries, increasing political risk. The money flowing in, meanwhile, has boosted some currencies to levels that could threat-

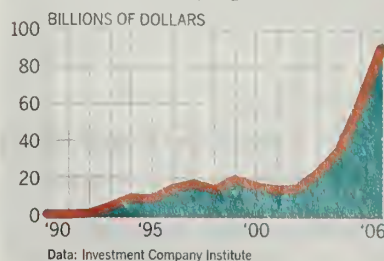
en growth.

If any of these were to spook investors, the rush for the exits could mean an unprecedented collapse

That's because there has never been much cash sloshing into emerging equities. In the 12 months through November 7% of all U.S. money invested in mutual funds went to emerging markets, up from 0.38% in 2000, according to Citigroup Investment Research. And as individual investors mail in their retirement-f

PILING IN

Assets in investment funds aimed at emerging markets





suries did. Today, the difference has fallen to less than two points as governments have used commodity windfalls to pay off loans. Investors "are spilling over into emerging-market equities that have traditionally been out of their comfort zone," says Christian Stracke, an analyst at bond researcher CreditSights.

A meltdown almost happened last June. Yields on 10-year Treasury notes hit a four-year high of 5.22%, raising fears of inflation and curbing investors' appetite for risk. Russian and Turkish stocks took a 30% haircut. Ditto Bombay's white-hot Sensex Index, whose plunge had police on the lookout for investor suicides. On average, bourses in emerging markets declined by 26% in four weeks; the \$20 billion pulled out in the second quarter equaled 20 months of money coming in the door. Sure, those markets roared back when Treasury yields came down, but the plunge gave investors a painful lesson in the volatility that accompanies so much eager money. "There is a lot of froth," says Andrew T. Foster, director of research at

Investors received a lesson in the markets' volatility last June, when stocks sank 26%

Matthews Asian Funds.

The Sensex has recovered, but India is still having a hard time digesting the cash flowing in. In December, the State Bank of India tried to curb runaway borrowing and rising wages with a half-point rate hike, sending stocks tumbling 7% in three days. "The inflation rate, the current-account deficit, property prices, and credit quality have already reached worrying levels," says Ridham Desai, joint head of research for JM Morgan Stanley Securities in Mumbai. "Policy-makers' abilities [are] limited."

Options are especially restricted for countries that compete with China. Beijing has continued to keep the yuan artificially low despite the money flooding into mainland markets. Smaller neighbors have seen their exports take a hit as hot money has pushed their currencies higher. That has led to some desperate measures. To stem the baht's steep

rise, for instance, Bangkok on Dec. 19 announced rules making it harder for investors to take cash out of the country. Thailand's stock market plunged 15% in one day, and emerging-market indexes the world over sold off in sympathy.

RUSSIAN DISCONNECT

ALTHOUGH MOST bourses quickly bounced back when Thailand canceled the plan, other countries might still consider capital controls. Indonesia's market jumped 60% last year, helping send the rupiah 7% higher against the dollar. And South Korea, Asia's No. 3 economy, saw the won rise 9% against the greenback in 2006. Since Korea represents an outsize chunk of the benchmark Morgan Stanley Capital International emerging-markets index, any currency intervention in Seoul could inspire a global sell-off.

Political turmoil elsewhere could be just as devastating. Nations that were perennial economic underdogs now have more economic muscle. Venezuela's Hugo Chávez, for instance, is parlaying oil wealth into a sphere of influence in Latin America. Chávez has shored up Havana and funded victorious leftist politicians in Bolivia and Ecuador. And by buying bonds from Argentina—a credit-markets pariah since it defaulted on international loans five years ago—he has sheltered Buenos Aires from angry creditors and helped stocks there jump tenfold since 2001. Chávez' growing influence means that a collapse in Caracas could take much of the continent down with it. These manipulations "make the market vulnerable to a pullback," says Walter Molano, partner with Greenwich (Conn.) investment bank BCP Securities.

Even more worrisome might be oil-flush Russia. The Soviet-style killings of ex-spy Alexander Litvinenko and others have raised fears of growing lawlessness. And Gazprom's shakedown of foreign oil companies looks like a creeping effort to reestablish state control of the energy sector. Nonetheless, investors love the place, sending stocks on the Moscow bourse up by 65% in 2006. "In my 10 years in Russia, I have never seen such systematically negative coverage in the Western press and such enthusiasm by the financial community for all Russian assets," says Eric Kraus, manager of the Nikitsky Russia/CIS Opportunities Fund in Moscow. "There is a total disconnect at this point." ■

—With Jason Bush in Moscow,
Cristina Lindblad in New York,
and Nandini Lakshman in Mumbai

checks in January, many expect the numbers to keep climbing. "People are saying, 'I used emerging markets for five years in '06. That's it, I'm in,'" says Donald Elef, portfolio manager of the \$1.1 billion Resior Emerging Markets fund. The record slim yields offered by emerging-market bonds have pushed even more money into stocks. Four years ago, bonds sold by developing countries paid about percentage points more than U.S. Treas-



HOT CARS

A BURST OF SPEED AT LAMBORGHINI

After years of restructuring, the sports car maker is finally a serious rival to Ferrari

BY GAIL EDMONDSON

STANLEY ATKINS LEFT HIS Jefferson (Ga.) home last summer to buy a sports car, fully expecting to drive home in a Ferrari. But the 55-year-old real estate investor felt snubbed by the Ferrari salesman, so he rolled down the road to rival Lamborghini—and never looked back. In fact, he was so smitten that he wound up buying two: a silver Gallardo Spyder convertible for \$274,000 and, three weeks later, a \$354,000 Murcielago roadster. “You go out in that car,” Atkins says, “and people are all over you.”

Lamborghini has long held mythic sway over car aficionados. Its exotic flying-saucer design, its horsepower on steroids, and its deafening engines have been a powerful draw for fans such as comedian Jay Leno and actor Jamie Foxx. But for years, Lamborghini suffered from financial woes and quality problems. The Italian super-sports-car maker went through six owners in 16 years and spent 1978-81 in bankruptcy. So for most of

Lamborghini's 44-year history, it has been a mere speck in Ferrari's rearview mirror, selling just about 250 cars a year.

Now an infusion of German cash is helping Lamborghini burn rubber. In 1998, automaker Audi bought the company. After spending some \$500 million revamping production and developing models, Lamborghini has the scale to mount a real challenge to Ferrari. In 2006, Lamborghini says it sold more than 2,000 cars, and sales in the U.S. shot up 48% in the first 10 months alone. The company today has about 100 showrooms worldwide, up from only 45 in 1998. Ferrari still has roughly twice as many dealers, but in 2007 Lamborghini plans to add 10 more in such far-flung locales as Mumbai and Kiev.

Besieged with orders, Lamborghini's factory in Sant'Agata Bolognese, near Mode-

SPYDER LINE
Lamborghini's models have a one-year waiting list

na, is running full turning out 10 cars a That's brisk, consider it takes a worker an tire day just to cut a hand-stitch one leat

seat. Still, it's not fast enough for all Lamborghini lovers getting in line. B the 640 hp Murcielago and the 520 Gallardo have a one-year waiting “Lamborghini was always a hotter br than Ferrari,” says Garel Rhys, a pro sor of automotive economics at Car University in Wales. “But it never tra lated into higher sales.”

VERSACE INTERIORS

WITH SALES FINALLY soaring, Lamh ghini is on a stronger financial fi ing, too. Cost-cutting has helped bo 2006 operating margins to nearly up from 1.8% in 2005, Morgan Star estimates. The brokerage predicts pre profit could more than double in 2007, \$14 million, as revenues increase 30% \$400 million. That's still small compa with Ferrari's expected 2006 sales \$1.9 billion and 5,400 cars. But by t ping into Audi's engineering expert purchasing power, and supplier r tionships, Lamborghini could eventu match Ferrari's sales—and surpass 12% operating margin.

To preserve its super-luxury im: Lamborghini will take a page from rari and pursue profits over growth 2007, it expects to expand sales less t 10%. “We are a niche of a niche,” s Chief Executive Stephan Winkelma “You can't increase volume at the s of a finger.” The former Fiat execu wants to boost earnings with limited-t tion models packed with pricey opti One example: a run of 20 Murcielag with interiors designed by fashion ho Versace—and selling for \$500,000.

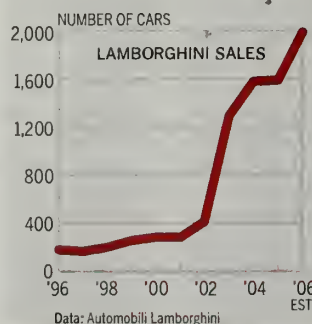
Another untapped vein for Lam ghini is clothing and other gear em zoned with its raging-bull logo. Ur

Audi, Lamborghini first concentrated developing hot r els and overhau manufacturing. P the company is star to license merchanc a business that ge ates some \$200 mil a year each for Fer and Porsche. A T-s with that half-mil dollar car, perhaps?

—With Ris

Chhatwal in Atl

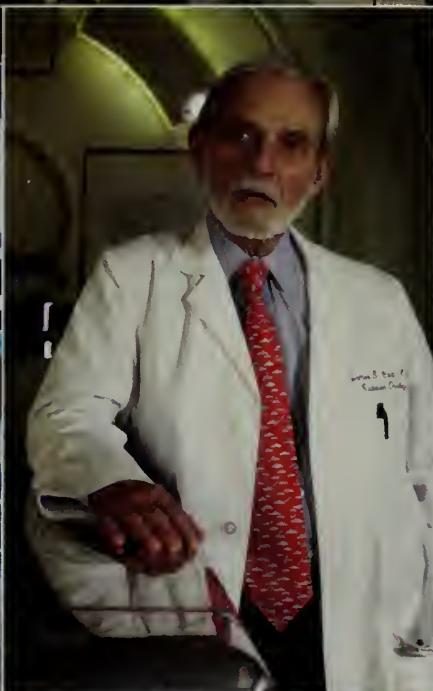
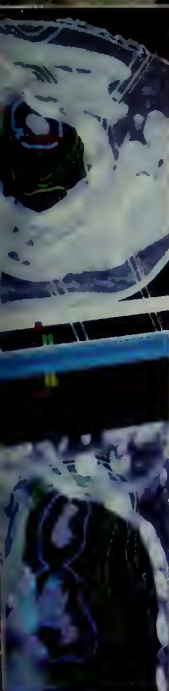
BURNING RUBBER



Hitachi | true stories

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HITACHI
Inspire the Next

BY STEVE HAMM
AND SPENCER E. ANTE

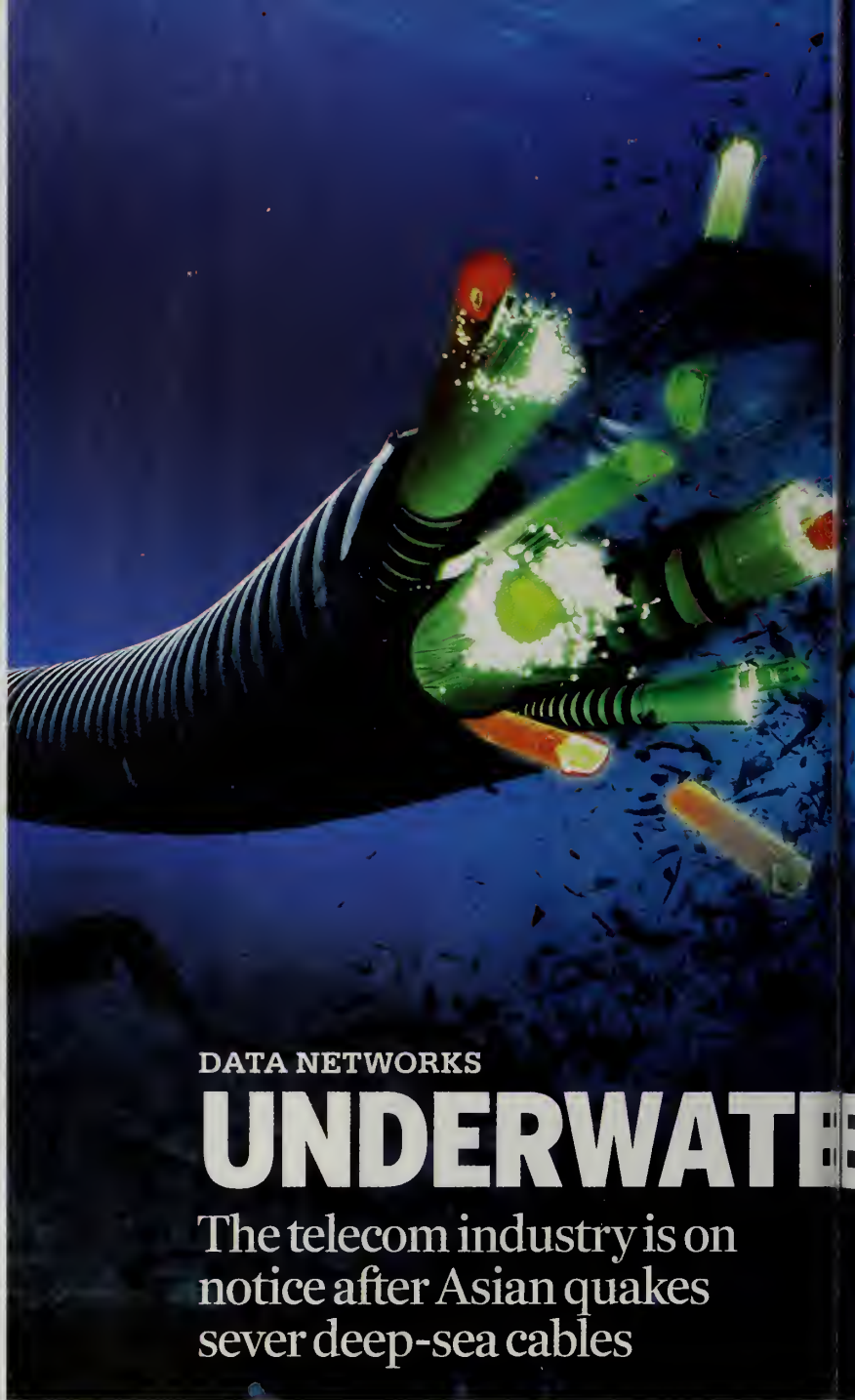
ON DEC. 31, THE *TYCO Durable*, a 420-foot repair vessel steaming south from Japan, reached the spot two miles above the Pacific Ocean floor where days earlier earthquakes had snapped eight undersea cable systems that make up much of the telecommunications lifeline for Asia. Aided by a navigation system that plotted the location of the fault, the crew lowered an anchor line with a specially designed grapnel hook on it. They located the 4-inch-thick cable, snipped it and dragged the severed end to the surface. The *Durable's* crew members expected to find the other end of the broken line over the next few days, so engineers could splice the two ends with a new strand of cable and get communications flowing again.

With these maneuvers, repairs began for one of the worst outages in telecom industry history. After earthquakes struck on Dec. 26, rock slides took out cables near Taiwan. Like dominoes, telephone and Internet networks toppled in Taiwan, China, South Korea, Japan, and India. Millions of calls couldn't be made, countless Web pages couldn't be opened, and online stock trades couldn't be consummated. Repairs could cost between \$500,000 and \$2 million per cut line, and it will likely be a month before all of the cables are fixed.

RISING PRICES

FOR ALL THE excitement about broadband, Wi-Fi, and mobile networks, this latest incident shows how surprisingly dependent the world's data are on submarine cables that snake through canyons on the ocean floor where they're vulnerable to fishermen's nets, ship anchors, and earthquakes. The risk is highest in the Pacific, the most seismically active part of the globe. With China becoming the world's manufacturing hub and India its software mecca, Asia is booming and network traffic is exploding. Yet today's undersea networks aren't up to the job. "Asia is already short on capacity," says Todd Underwood, chief operating officer at Renesys Corp., a Net monitoring company. "This is going to be a long-term deal, and it will impact a lot of global companies."

The incident comes at a time when the huge glut of communications capacity built up during the dot-com era has finally been worked off. Prices for transpacific services are rising for the



DATA NETWORKS

UNDERWATER

The telecom industry is on notice after Asian quakes sever deep-sea cables

first time in half a decade. Monthly leasing prices have jumped 10% to 25% over the past year depending on the route, according to TeleGeography Research Group, which tracks undersea cable trends. "The period of rapid price declines is over in much of Asia. We may see modest price increases in the next year," says analyst Stephan Beckert of TeleGeography. He forecasts increases of 5% to 10%.

Relief is on the way, but it will take time to arrive. Three operators have major transpacific systems in the works. Two are to be finished by the end of 2008, while the third is due in 2009. Projects

like these each cost anywhere from \$1 million to \$1.5 billion and are often financed by consortia.

'RING OF FIRE'

ONE OF THOSE new Pacific systems is part of a massive \$1.5 billion global build-out connecting 60 countries, India's FLAG Telecom. "We're building a global 'infobahn.' We're encircling the world with fiber loops so you have a lot of interconnectivity and a lot of resilience," says FLAG Chief Executive Punit Garg.

Laying undersea cable systems is a monumental process. After surveying landing sites, studying seabed geology

ERIL

assessing risks, engineers
a route. A company like
giving delivers strands of
r-optic glass to a manu-
rurer—say, Tyco Telecom-
munications—which encases

fiber in metal. Then gigantic spools
able, repeaters that transmit signals
g distances, and other gear are loaded
cable-laying vessels. For months, the
s lower the cables thousands of feet to
seabed. In congested spots, engineers
s robots to dig trenches for the cable
protect it from wayward anchors and
sng nets. Then crews haul the cable
s above water and connect them to

SNAP! Fishing
nets, anchors, and
earthquakes can
wreak havoc on
undersea cables

ing built by Verizon Communications Inc.
and five Asian partners, including China
Telecommunications Corp., takes advan-
tage of the latest in undersea engineering.
Traditional cross-ocean systems are loops
made up of two cables, usually many miles
apart. The Transpacific Express will use
“mesh” systems that provide more redun-
dancy by running three loops and connect-
ing all three at switching stations on shore.



land-based stations.

Until these new cable systems get lit up, telecom planners will be worrying about the next major Pacific quake. Place a map of the region's major fault lines over one showing the cable routes, and you see that nearly every cable crosses one or more faults. "This is a highly active area. It's the ring of fire, where earthquakes are concentrated," says Randy Baldwin, a geophysicist with the U.S. Geological Survey in Golden, Colo. On average, there are 18 "major" or "great" quakes a year, many of them in the Pacific.

Operators building new cable systems are mindful of the earthquake threat and do what they can to avoid it. The new Asia-America Gateway, running from Southeast Asia to the U.S., is being routed to the south of the most active seismic zones. And the Transpacific Express, which is being

That makes it easier to reroute traffic if there's a break.

Engineering experts say the Taiwan incident should persuade all operators to do more to prepare for quakes. It's not good enough if you have a variety of routes but then bring them into shore at the same location—especially if, as in the Taiwan case, they're crossing a fault line right there. "The main lesson is to look at where the fault lines are and put in geographic diversity to avoid having a few points of failure," says Stig L. Nilsson, director of the electrical practice at Exponent Inc., an engineering consultancy in Menlo Park, Calif.

QUICK FIXES

BUT THERE'S ANOTHER lesson: The global telecom network really is quite resilient, even in the face of such a crippling blow. Within 12 hours of the undersea rock slides, at least partial service had been restored to most of the affected networks. This was done by rerouting traffic via land and sea through Europe to the U.S.

India, in particular, has become obsessed with telecom reliability, given its huge bet on call centers and software-coding shops that can't afford to be offline for long. That helped the country avoid the disruptions felt in Taiwan and China. A survey by NASSCOM, the country's software trade association, found that only one large company suffered a major outage, of eight hours. Other big companies were affected only slightly. The reason: They tap multiple telecom service providers and use four separate cable systems that come to shore in different Indian cities. In the telecom network, as in other human endeavors, there's strength in diversity. ■



BEER

A SHINING LIGHT FOR HEINEKEN

Its Premium Light, while still a bit player, is drawing lots of attention from Joe Six-Pack

BY ADRIENNE CARTER

THE CHICAGO NEIGHBORHOOD Wrigleyville is best known as the home of its namesake, baseball stadium Wrigley Field. With nearly 100 bars packed into one square mile, it's also a concentrated microcosm of beer drinking. At bars like Sluggers, Casey Moran's, and Cubby Bear, two domestic light beers reign supreme with young professionals and baseball fans: Miller Lite and Bud Light.

Baseball and beer. Is anything more American? Not if Heineken has anything to say about it. Last March, the Dutch brewer launched an assault on the hugely profitable \$30 billion domestic light beer market with its new Premium Light brew. Ten months later, Heineken's light beer remains a pipsqueak next to Bud and Miller, but it's making a big impression. Anheuser-Busch Cos. partly attributed weak sales of its light brands in the latest quarter to the new entrant's strength. And beer drinkers are voting with their gullets. "Bud Light has a watered-down taste," says Andy Anderson, a 28-year-old Chicago business student and Cubs fan. "Heineken Light has more flavor."

What Heineken has done is come up with a beer that appeals to Joe Six-Pack without losing the brand's European cachet. Even better, it sells at a premium over domestic brews. At Dark Horse Tap & Grille in Wrigleyville, a 12-ounce bottle of Heineken Premium Light goes for \$4.25, vs. \$3.75 for Bud Light. Meanwhile, Heineken has managed not to cannibalize sales from its original brew, the No. 2 import after Corona. In fact, the new beer appears to be giving the old one a lift.

One of the brewer's best moves may be the bottle. Its green glass and short neck are pure Heineken. And a slimmer, taller silhouette gives it a modern, minimalist look. "It's like a pretty girl you coveted," says Harry Schumacher of *Beer Business Daily*, "a little treasure you want in your refrigerator."

The brewer highlights the bottle on billboards and in ads, a departure from the sophomoric humor or sexy women typically used to attract the young males,

aged 21 to 2 who quaff the bulk light beers. Yes, the brewer's TV spots feature pop tunes like "Don't Cha" by the Pussycat Dolls. But you don't see the scantily clad sinners; the bottle takes center stage. The approach is mirrored in the "Smooth Flight" promotion in bars, where "flight attendants" let barflies drinking competing brews "trade up to first class" with free Premium Light.

Coming up with the right brew was easy. Heineken had to appeal to the light drinker's palate. For example, Bud Light has a pale, amber color and a crisp taste. Still, Heineken knew it needed to play to the strengths of its core lager brand, which has a full flavor and rich, tawny color. Ultimately, finding the right balance took 15 months and 20 different versions. "We've been able to deliver a beer that plays in the light beer sandbox but is true to the Heineken brand," says Heineken USA's chief, Andy Thomas.

Although sales have been sluggish in recent years, light beer accounts for more than half of the overall beer market, up from 30% a decade ago. While more consumers have been drinking crafts and imports, which have been growing as much as 10% a year, imports make up just 2% of the light category, vs. roughly a quarter for full-calorie brews.

THE STAT

50%

Amount Heineken has increased Premium Light sales estimates for 2006.

Data: Heineken

Heineken thinks it has hit the sudsy spot. It estimates it sold 510,000 barrels of Premium Light in 2006, up 50% from its original projection. There's little chance it will soon catch up to Bud Light, which sells more than 40 million barrels a year. But analysts figure that Heineken will easily double sales of its light brew to more than 1 million barrels by the end of 2007—remarkable for a newcomer. "[Heineken Premium Light] is taking share from domestic light beers as well as imports," says Charles Norton, co-manager of Vanguard Fund, which owns Heineken. "It's the best of both worlds." ■

BusinessWeek.com To watch a video interview with Andy Thomas, CEO of Heineken USA, go to www.businessweek.com/go/tv/heineken

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Ontario has been home to one breakthrough discovery after another. In 1961, Lasker Award-winning scientists James Edgar Till and Ernest Armstrong McCulloch proved the existence of stem cells. Today, Canada leads the world in cancer research, according to a 2006 study by The FASEB Journal. In Ontario, Dr. Tony Pawson has made major discoveries in cell signaling; other Ontario scientists have found novel ways to treat cancer with viruses; and we've made advances in imaging to improve mammography, surgery and therapy. We're committed to even greater achievements in the future. Our 44 universities and colleges ensure a steady supply of graduates in science, mathematics and engineering every year. In fact, 56% of our workforce has a post-secondary education – the highest rate in the industrialized world. And their potential is maximized by a competitive economy committed to the commercialization of research and innovation. It's time to make a major discovery of your own: Ontario. There's no better place in the world to do business.

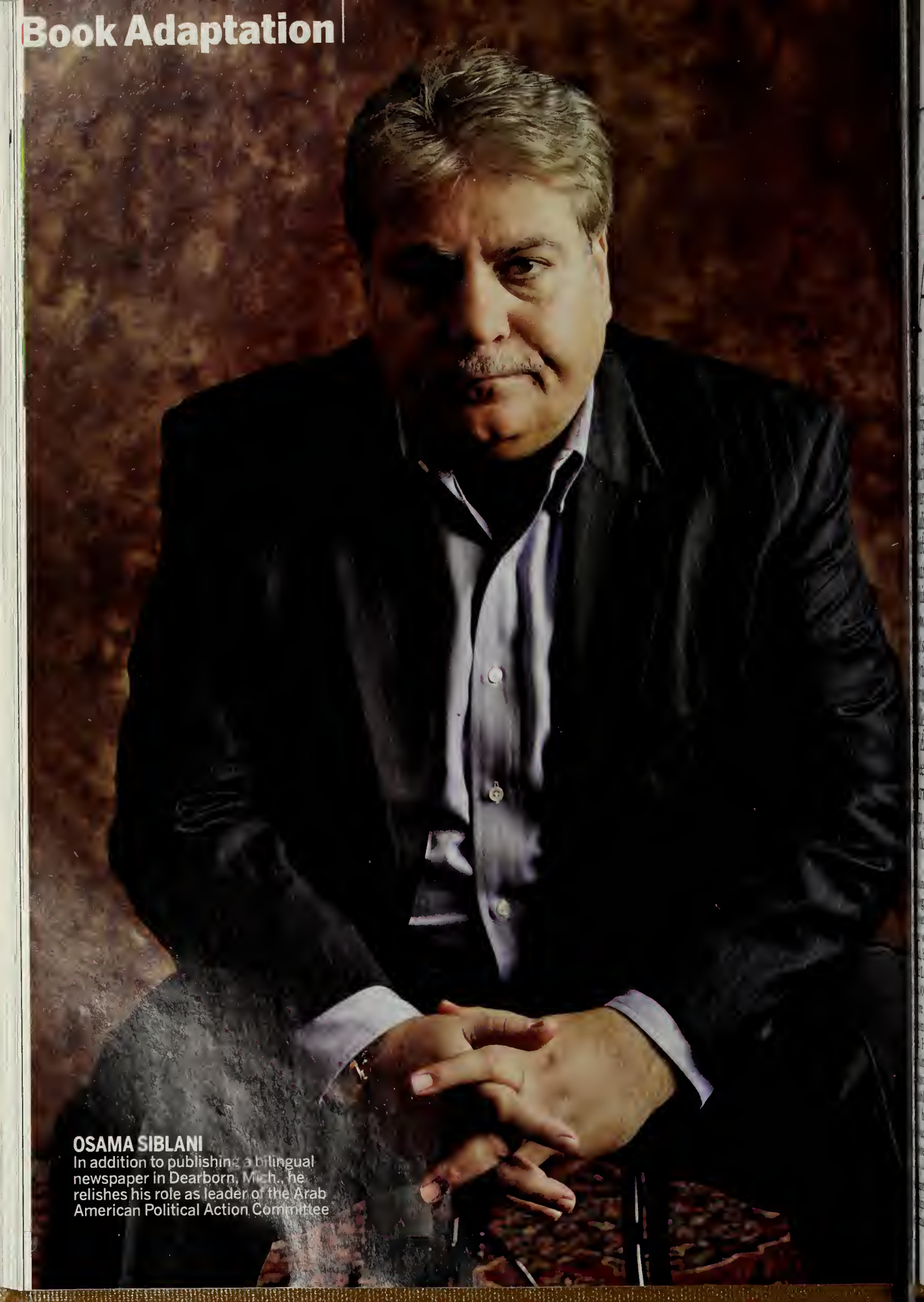


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Book Adaptation

A portrait of Osama Siblani, a man with grey hair and a mustache, wearing a dark suit jacket over a light blue button-down shirt. He is sitting with his hands clasped in front of him, looking directly at the camera with a serious expression. The background is a dark, textured wall.

OSAMA SIBLANI

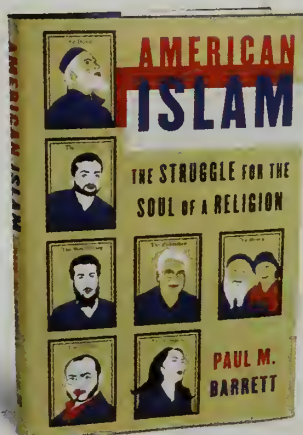
In addition to publishing a bilingual newspaper in Dearborn, Mich., he relishes his role as leader of the Arab American Political Action Committee

They're Muslims, And Yankees, Too

Muslims in America represent most every variety of Islam—thought and experience. The heavily secular and prosperous Arabian community in Southern California has little in common with orthodox Yemeni laborers near Detroit. College-educated white converts whose interest in New Age concepts leads them to the spiritual Sufi branch of Islam do not resemble poor black prison inmates who embrace Muslim beliefs behind bars as a source of discipline and solace. Indeed, as *BusinessWeek* Assistant Managing Editor Paul M. Barrett explains in his new book, *American Islam, the U.S. can be seen as a vast experiment in how Islam can adapt to the West.*

Business is good these days at *The Arab American News*. The bilingual weekly newspaper in Dearborn, Mich., bulges with patches on strife in the Middle East. Its columnists bristle at what they see as America's many misdeeds in the region. It, boosted by readers' anxiety over bloodshed in Iraq, Gaza, and Lebanon, circulation has risen 60% over the past year, to 10,000, says Osama Siblani, the publisher and editor-in-chief. More advertisers have come with the growing readership, and among employers buying substantial help-wanted ads is the U.S. Homeland Security Dept., which desperately needs Arabic linguists. A fierce critic of American foreign policy, Siblani acknowledges the irony of his profiting from the U.S. security establishment. "It seems like the niche we have is working for the deadpans.

Such incongruities permeate Muslim lives in Dearborn, where auto factory jobs have drawn Arab immigrants since



adapted from *American Islam: The Struggle for the Soul of a Religion*, by Paul M. Barrett, published on Jan. 2, 2007, by Farrar, Straus & Giroux. Copyright © 2007 by Paul M. Barrett

the 1920s, making the gritty Detroit suburb the unofficial capital of Arab America. Muslims there and around the country are the objects of suspicion and in some cases prejudice, especially since the attacks of September 11, 2001. But as a group, they offer a model of assimilation and material success. An astounding 59% of Muslim adults in the U.S. have a college degree, compared with only 28% of all American adults. Surveys show that median family income among America's Muslims exceeds the national figure of \$55,800. And four out of five eligible Muslims are registered to vote, slightly higher than the overall rate.

The duality of Muslim-American life often surfaces in the tension between allegiance to an adopted land and to causes back in the old country that most Americans view as dangerous. For example, in addition to running his newspaper, Siblani relishes his role as a leader of the Dearborn-based Arab American Political Action Committee. The group's endorsement has been avidly sought by candidates of both parties running for everything from Michigan county judgeships to the White House. But during last summer's clash between Israel and Hezbollah, Siblani and some fellow Lebanese immigrants made no secret—at rallies and in statements to the media—of their sympathy for Hezbollah, an Iranian-backed Lebanese militia and political movement.

Jewish leaders attacked Siblani and his allies for supporting an organization committed to Israel's destruction and considered terrorist in nature by the U.S. government. And during the fall election season, a number of state and national politicians who normally woo the Detroit area's large Arab-American constituency steered clear, at least in public. This infuriates Siblani, who insists that his main concern last summer was pressuring Washington to seek a swift cease-fire in Lebanon.

Siblani, a pro-business, anti-abortion Republican who drives a sleek black Mercedes and lives in a comfortable house complete with white pillars in front, helped organize Arab American support for George W. Bush in 2000. But the President's "war on terror" after 9/11 left him feeling that his adopted country had turned against Muslims. He abandoned Bush in 2004 and publicly branded the current administration the "Taliban in Washington."

Siblani reflects the complexity of American Islam, an intricate mixture of creeds and cultures: immigrant and native-born, devout and secular, moderate and radical. By comparison, most

immigrant Muslims in such countries as France, England, and Spain have remained poorer, less well educated, and more marginalized. Europeans encouraged Muslim immigration as a source of menial labor, but until recently did little to integrate workers as citizens. And more generous welfare benefits in Europe allow Muslims and other immigrants to live indefinitely on the periphery of society. The American combination of a comparatively modest social safety net with greater economic opportunity appears to have drawn Muslims willing to adjust to new customs and acquire education needed for good jobs. So the ideologically motivated violence that has erupted in Muslim enclaves in Western Europe so far hasn't surfaced from within the U.S.

What follows are glimpses into the lives of four successful American Muslims. They suggest both the variety and flux within Islam in this country.

The Publisher

OSAMA SIBLANI arrived in Detroit from Lebanon in 1976 at the age of 21. He had \$180 in his pocket and little else. Within days he held three jobs: parking cars, pumping gas, and delivering pizza. In the space of four years he earned an engineering degree at the University of Detroit and landed a high-paying post with an export company selling equipment to Middle Eastern builders. He lived well in the Detroit suburbs and fixed up his mother's house in a village near Beirut, the same house where he was raised. "This is the American dream," he says. "It doesn't matter who you are or whether you have anything to start. You can make something of yourself."

But the trajectory of Siblani's life shifted in June, 1982, when Israel invaded Lebanon, seeking to crush the Palestine Liberation Organization and install a friendly Christian government in Beirut. An Israeli aerial bomb destroyed his mother's house. She and other family members survived unhurt, but the dwelling was left in cinders. The furniture, washer-dryer, and television Siblani had bought his mother were ruined. "My letters from lovers I had when I was in school, my pictures. I don't have any pictures from when I was little," he said. "Who burned it? Israeli jets."

His admiration for Hezbollah stems from the movement's resistance to Israel and its provision of social services to the poor, not from any enthusiasm for Hezbollah's goal of establishing an Islamic theocracy. Siblani, who rarely attends mosque, favors secular democ-

racy. Determined to provide an alternative to what he saw the pro-Israeli perspective of the American media, he quit his export job and started *The Arab American News* in 1984.

He lacked any journalism experience and had to use savings and credit cards to finance the venture. Arabic typesetting equipment wasn't available in the Detroit area, so he shipped some in from England and Saudi Arabia. The newspaper quickly gained notice among Arab immigrants, but Siblani's enthusiasm for growth led to costs outstripping revenue. In 1994, his credit cards tapped out, the publisher declared personal bankruptcy, losing his home and car.

Gradually, he pieced things back together, and today, he says, the paper has achieved financial stability. The real payoff for Siblani is that he can vent his plentiful political opinions via a First Amendment-protected business—something he acknowledges isn't possible in most Arab countries. "I would never pretend that I am a journalist out to tell the story without feelings, without bias," he says. "I am a journalist on a mission. I want to tell the story. I don't want somebody else to come and tell it."

The Lawyer

NAZISH AGHA recognizes that many Americans would be surprised that an observant Muslim woman could work comfortably at a top New York law firm, let alone one with a name like Cadwalader, Wickersham & Taft. Many Muslims, even in this country, would similarly be surprised—and disapproving. Agha is used to it. As an undergraduate at Yale University in the early 1990s, she encountered male Muslim classmates who savagely criticized her friendship with non-Muslims and forbade her to wear *hijab*, the traditional Muslim head covering. "I had a Muslim guy tell me it was a lost cause," she recalls. By contrast, in the high-end law world, her religion has seemed a nonissue. "People look at the work you do," she explains.

Agha, who is in her mid-30s, wears subdued business suits and has long wavy chestnut-brown hair. She came to America from India with her family as a small child. An observant Shiite Muslim, she nevertheless describes her path to accomplishment as defined by "the typical Protestant work ethic." Public school teachers in suburban New Jersey persuaded her parents to send her to Groton, the quintessential New England prep school, where she



NAZISH AGHA

A lawyer at Cadwalader, Wickersham & Taft, she says American Muslims vary widely in their views about whether women should work outside the home



IS WASI AND HIS ELDEST SON

convert to Islam, Wasi appreciated that he saw as the religion's clear-cut rules. Neither he nor any of his six children drinks or smokes, he says.

French and Latin. Yale followed and then law school at Georgetown University. Today she has a 32nd-floor office with a sweeping view of New York Harbor and the Statue of Liberty. She helps engineer corporate mergers and acquisitions as an associate with Cadwalader, which boasts a Wall Street practice dating from the 1790s. On top of working long hours for paying clients, Agha has offered pro bono counsel to fledgling artistic groups and those protecting abused women.

She explains that opinions among American Muslims vary widely on whether women should work outside the home and on what sorts of jobs they ought to hold. Law, in particular, seems like an appropriate pursuit, she says, pointing to the Islamic tradition in which being "a jurist is considered quite a noble profession." For more than a millennium, Muslim legal scholars have imparted influential interpreta-

tions of the *Quran* and the sayings of the prophet Muhammad. During medieval times, some of these scholars were women, although they are mostly forgotten today. Agha sees her practice of corporate law as growing from this jurisprudential heritage: "It is about relationships and fairness—between human beings, between industry and government, and between contracting parties."

The Baker

IDRIS ABDUL WASI runs Abu's Homestyle Bakery just down the street from Masjid At-Taqlwa, a well-known house of worship in the tough Bedford-Stuyvesant section of Brooklyn, N.Y. One of the mosque's respected elders, Wasi does a brisk business in sweet-potato and bean pies, as well as heavy German chocolate cake. Wasi is African American, a convert to Islam but not a follower of Louis Farrakhan. In recent years, Farrakhan's idiosyncratic Nation of Islam has dwindled in prominence, as the majority of black Muslims have switched their allegiance to increasingly independent African-American and nonblack imams.

A native New Yorker, Wasi sang in the choir at Bushwick Methodist Church as a boy, but he says that "the whole Trinity thing never really penetrated my heart or my head." This is a common complaint from American converts to Islam, both black and white: that they couldn't make sense of the idea that the Father, Son, and Holy Ghost are all parts of one God. Wasi, now in his early 50s, saw Islam as a more logical approach

to monotheism: one deity, pure and simple. He also appreciated what he saw as Islam's more clear-cut rules. "Coming up a child of the '70s, I was into the intoxicants, the lifestyle," he explains. His father, a longshoreman, drank himself to an early death. Wasi's mother was remarried to a Muslim and converted. Wasi's two younger brothers embraced Islam as well. In 1976, while a junior at John Jay College on Manhattan's West Side, Wasi followed suit. The only college graduate in his generation of his extended family, he has six children, all raised as Muslims. Not one drinks or smokes, he says.

About three years ago, when Wasi fell ill for a time, his oldest son, also named Idris, left the Web development firm he ran and came to work at the bakery. The younger Idris, though a practicing Muslim, decided that the family business, which serves a mostly black, non-Muslim clientele, would benefit if the religious motif were slightly toned down. "Abu,"

which means father in Arabic, remained in the shop's name, but the younger Idris inserted "Homestyle." He removed a sign declaring, "There is no god except Allah." But the bakery still distributes pamphlets proselytizing Islam and doesn't sell Christmas cookies in December. "It may hurt business, but we have certain values," the younger Idris, 35, says.

African-American Islam began with Muslim slaves brought from West Africa. But Christian slave owners suppressed Muslim belief and ritual, and African-American Islam faded. In the early twentieth century, black fraternal associations reintroduced Islamic themes to assert an independent identity in a still hostile white society. That tradition continues today, lending black Islam a rebelliousness to which the elder Wasi sometimes gives voice.

"There are elements in the media and society who are clearly enemies to Islam," he asserts. "They'll do anything they possibly can to turn the society against Muslims." He enjoys talking about business and has an inventive theory about one force generating the assault against Islam. He thinks manufacturers of cigarettes and alcohol have grown alarmed over the religion's ability to steer African Americans and others away from smoking and drinking. The companies "are not going to sit back and allow that to happen," he says, and they could be the ones influencing the media to depict Islam unfavorably. He has no proof but still says: "It's almost as if, whenever there's a concerted effort to do something positive to uplift ourselves, there's this [opposing] effort to divert us."

The Executive

MONEM SALAM aims for understatement: a charcoal-gray, buttoned-down look, soft voice, and modest demeanor. But when pressed, he admits he has achieved a pretty impressive formula for combining spiritual and material interests. The 34-year-old Pakistani immigrant oversees Islamic investing for Saturna Capital Corp., a Bellingham (Wash.) firm offering Muslims mutual funds that hew to the strictures of *Shariah*, or traditional Islamic law. With \$400 million in client money, Saturna's two Islamic stock funds are tiny by industry standards. But historically they



MONEM SALAM

The Pakistani immigrant helps run mutual funds that follow Islamic law. His portfolio avoids companies that deal in alcohol, pork, or pornography.

.....

have reported solid results. For 2006, the more conservative stock fund reported a 22% return; the more aggressive growth fund, 15%. And the mere existence of the funds and a handful of rivals are a source of pride among American Muslims, including many who do always observe the *Shariah's* prohibitions.

Salam moved to Saturna in 2003, leaving behind a money manager's job in Dallas with Morgan Stanley. Nowadays he and his wife and three young children live in Bellingham, the picturesque harbor town where Saturna has its 25-person office. Salam says he is "more at peace doing something to help Muslims and doing it a way [with which] I would be happy."

With guidance from Islamic scholars, Salam helps shape a portfolio that excludes companies that deal primarily in alcohol, pork, or pornography. There are no gambling stocks and most challenging, no equities in banks, because Islamic law bans the imposition of payment of interest as a form of usury. Small purities are permitted:

funds can own airline stocks, even though flight attendants serve liquor. Lately the funds have favored technology and telecommunications. The fact that companies borrow money doesn't preclude Salam from buying their shares; he monitors the ratio of debt to market capitalization and avoids corporations that leverage to the hilt. "You have to allow some leeway, or you can't do anything," he tells audiences at Muslim investing seminars around the country. Only a small minority of American Muslims, perhaps 10% by Salam's estimate, even attempt to follow *Shariah* restrictions in all of their financial dealings. His goal is to make that percentage grow.

In his spare time, Salam takes flying lessons. His father, a retired commercial pilot, flew Boeing 747s for airlines based in Pakistan and Saudi Arabia. Salam knows that after 9/11, a Muslim showing up at an American flight school could suggest something ominous to some people. That's part of the reason he's doing it: to show that Muslims can fly just as innocuously as other Americans. Even as he sells mutual funds with an Islamic twist, he hopes his life demonstrates that "being an American Muslim is not an oxymoron." So far his flight training has gone smoothly, and Salam, whose surname means "peace" in Arabic, expects to get his pilot license in the spring. ■

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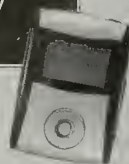
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OUT AT HOME DEPOT

Behind the flameout of controversial CEO Bob Nardelli. BY BRIAN GROW



IN THE END it came down to the headstrong CEO's refusal to accept even a symbolic reduction in his stock package. Home Depot Inc.'s board of directors wanted their controversial chief executive, Robert L. Nardelli, to amend his whopping compensation deals for recent years. After he pulled down \$38.1 million from his last yearly con-

tract, angry investors were promising an ugly fight at the company's annual meeting in May. Nardelli agreed to give up a guarantee that he would continue to receive a minimum \$3 million bonus each year. But that's as far as he would go. When board members asked him to more closely tie his future stock awards to shareholder gains, he refused, according to people familiar with the matter. Nardelli has complained for years that share price is the one measure of company performance that he can't control. After weeks of secret negotiations, things came to a head at a board meeting on Jan. 2, leading to Home Depot's stunning announcement the next day that the company and Nardelli had "mutually agreed" that he would resign.

"The board loved him and hates the way this ended up," says a person familiar with the matter. But in a season of growing antipathy toward extravagantly paid executives, the directors felt they had no choice. On his way out the door, however, Nardelli negotiated another jaw-dropper: a \$210 million retirement package that assures that he and his former employer will remain at the center of the swirling debate over CEO compensation. Nardelli declined to comment.

The sudden fall of one of America's best-known CEOs illustrates how perilous times have become for corporate leaders. Pointing to gargantuan pay and widespread manipulation of stock options, institutional shareholders are calling for top executives and board members to be held accountable (page 59).

At Home Depot there were other points of contention: a sluggish stock price in an otherwise rising market and Nardelli's notoriously imperious manner. Judged solely by certain company financial measures, Nardelli, 58, should have enjoyed acclaim for transforming Home Depot from a faltering retail chain into an earnings juggernaut. Driven by a housing and home improvement boom, sales soared from \$46 billion in 2000, the year Nardelli took over, to \$81.5 billion in 2005, an average annual growth rate of 12%. Profits more than doubled, to \$5.8 billion that year.

Tumultuous Tenure

DURING THE CURRENT housing slowdown, however, the nancials have eroded. In the third quarter of 2006, same-store sales at Home Depot's 2,127 retail stores declined 5.1%. And with the stock price recently stuck at just over 40, roughly same as when Nardelli arrived six years ago, he could no longer rely on other sterile metrics to assuage the quivering anger and arrogance provoked within every one of his key constituencies: employees, customers, and shareholders. Nardelli's "numbers were quite good," says Matthew J. Fassler, an analyst at Goldman Sachs Group Inc. But "the fact is that this retail organization never really embraced his leadership style." The CEO's reputation also suffered because of Wall Street's affection



Home Depot's smaller archrival, Lowe's Companies, whose stock price has soared more than 200% since 2000, while Home Depot's shares declined 6%, according to Bloomberg data (page 62). A simmering options backdating investigation at Home Depot hasn't helped matters either, though an internal company review has thus far exonerated Nardelli.

At another time, Nardelli's impressive operating numbers might have saved him. Perhaps he would have learned to temper an ego nurtured during a long career at General Electric Co. But in a prolonged season of hostility toward overweening CEOs, the former GE power systems phenom couldn't hold on. "He's not a very humble guy. He seems to have enormous energy but needs to be front and center, and that can wear on the board and the employees after a while," says Edward E. Lawler, director of the Center for Effective Organizations at the University of Southern California's Marshall School of Business.

Before the final fallout over pay, the half-hour that defined Nardelli's tumultuous tenure began at 9 a.m. on Thursday, May 28. That was the time set for the giant home-improvement retailer's 2006 annual meeting in a Wilmington (Del.) ballroom. The assembled shareholders—a sparse crowd of longtime stockholders, employees, and union representatives—expected the usual corporate routine: a presentation on the state of Home Depot's \$81.5 billion business, a vote on an assortment of shareholder proposals, and plenty of time for questions aimed at Nardelli and the other 10 members of Home Depot's board.

But something strange soon became apparent: The board wasn't there. Citing time constraints and the imperative of working on important matters back home at Atlanta headquarters, the eminent overseers of Home Depot failed to show up at their own event. That left Nardelli to handle the meeting on his own. He did that in an abrupt 30 minutes. Shareholders were



BIG BOX IN THE BIG APPLE

Nardelli steadily drove up both sales and margins until this ye

limited to just one question each: a digital clock timed them: One minute, then the microphone cut o

Nardelli spent much of the spring offering half-hearted culpitas for the board's disappointing act. "We tried a new for It didn't work," he said. But t as the months unfolded, it bec clear he had a problem on hands that he couldn't just s marily dismiss. A chagrined b signaled that it planned to rec his 2006 pay package, setting

stage for the ultimate Jan. 2 showdown on the stock plan.

'Maniacal'

NARDELLI ARRIVED at Home Depot after losing out in 2000 in a three-way race to succeed GE's legendary Jack Welch. Des that setback, Nardelli was anointed one of Corporate Amer most talented executives, and Home Depot seemed to l scored a big victory by snaring him. Almost immediately, he barked on an aggressive plan to centralize control of the nation's second-largest retailer after Wal-Mart Stores Inc. He inve more than \$1 billion in new technology, such as self-check aisles and inventory management systems that generated re of data. He declared that he wanted to measure virtually ev thing that happened at the company and hold executives str accountable for meeting their numbers. All this was new, relatively laid-back organization known for the independ of its store managers and the folksy, entrepreneurial sty retired co-founders Bernard Marcus and Arthur M. Blank. of Nardelli's favorite sayings is: "Facts are friendly." He see less concerned about people being friendly. Some saw this strength. "This guy is maniacal about goals, objectivity, ac plishments within the boundaries of the values of the compa

NARDELLI'S NUMBERS

After a good run, financial results are faltering



THIS PROXY SEASON, EXPECT A BRAWL

BY JENA MCGREGOR

With Robert Nardelli's resignation from Home Depot on Jan. 3, the shareholder activist community lost one of its favorite targets: the man who had become a poster child for sky-high executive pay, corporate arrogance, and board coziness. His low popularity was one reason Home Depot Inc. was high on the list of companies expected to bear the brunt of investor ire come this year's proxy season.

But Nardelli's exit hardly means it will be a quiet year. Add up shareholder anger over the backdating scandal, a slate of new rules on executive pay disclosure, increasing pressure from activist hedge funds, and more companies requiring directors to be elected by a majority shareholder vote, and a tempestuous proxy period lies ahead. "It's going to be very ugly," says Charles M. Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "The elements are all in place for a highly divisive season."

The biggest squall is going to come from the new pay disclosure rules, adopted by the SEC in July, which for the first time require companies to disclose the true size of their top executives' pay packages. They make companies reveal previously buried details, such as accumulated pension benefits, deferred compensation, and perks that exceed more than \$10,000 in total value. Corporations will also have to provide a plain-English table that summarizes executives' various forms of compensation. "That's going to be a shocking number for a lot of people," says Shekhar Purohit, a principal in the Chicago office of James F. Reda & Associates, an executive compensation and corporate governance consulting firm.

Despite the SEC's Dec. 22 decision to change the way stock option grants are measured in the summary tables—seen by shareholder groups as a Christmas gift to *BusinessWeek*—the new rules are expected to bring about plenty of additional fury over outsized pay. Some of the biggest

reactions may come from revelations about change-in-control agreements, which dictate what executives will receive in mergers or acquisitions, and from the terms of executives' retirement or severance packages. "The biggest holy-cow number now is likely to be that severance number," says Patrick McGurn, executive vice-president at proxy adviser Institutional Shareholder Services Inc.

While most of the outrage over company-paid country club dues and rich retirement bankrolls is likely to be focused on CEOs, some governance experts expect greater heat on compensation committee board members, too. "I believe the theme of this proxy season is going to be individual directors," says Nell Minow, editor and co-founder of governance adviser The Corporate Library.



It's going to be very ugly."

GOVERNANCE EXPERT CHARLES ELSON

"I would not be surprised to see no votes for the members of [Home Depot's] compensation committee." Some large pension funds are already sounding the alarm. "We're going to hold compensation committees accountable for giving away the shareholders' money in a way that provides no benefit to us," says Richard Ferlauto, director of pension and benefit policy for the American Federation of State, County & Municipal Employees (AFSCME).

Even entrenched family owners who control voting shares in their companies are feeling pressure. While there are no signs that New York Times Co. Chairman Arthur Sulzberger Jr. will be ousted—his family controls the bulk of Class B shares—he and his media empire, whose stock is down 50% since mid-2002, face pressure as a leading investor, Morgan Stanley Investment Management, pushes for a shareholder vote on the dual class structure and a separation of the chairman and publisher jobs, both held by Sulzberger. Following last year's

annual meeting, when the holders of more than a quarter of the company's common shares withheld votes for the directors, the Times faced rumors it could be a takeover target. In December, CEO Janet L. Robinson said: "The Ochs Sulzberger family...has no intention of opening our doors to the kind of action that is tearing at the heart of some of the other great journalistic institutions in our country." A spokeswoman declined to comment further on possible proxy fights.

Restaurants, too, continue to be a magnet for institutional shareholder agitation, particularly in the wake of the activist victory at Wendy's International, which recently spun off its Tim Hortons Inc. donut chain and shed underperforming assets. Former SEC Chairman Richard C. Breeden is using his hedge fund's 5% stake in Applebee's International Inc. to drive improvements at the underperforming casual eatery chain. He's demanding greater franchising, divestitures, and that cash be returned to shareholders. Vexed that Applebee's amended its bylaws to thwart his director nominations, Breeden publicly wrote to the board in December.

"The company's dismal performance record shows that the time is past for 'more of the same,'" he said, "and we believe the board needs fresh thinking, financial discipline, and new leadership." Applebee's declined to comment.

Home Depot may have battles ahead, too. Relational Investors (page 56), a shareholder that recently pushed for changes at Home Depot, still wants to see a broad shift in corporate strategy and capital expenditures and is demanding face time with management. Governance advisers are waiting to hear what Nardelli's successor, Vice-Chairman Frank Blake, will be paid before deciding if the board has changed its tune on executive pay. And despite praise from some institutional investors over Nardelli's resignation, others are still outraged by his roughly \$210 million severance package. "I wouldn't even say golden parachute," says AFSCME's Ferlauto. "I would say platinum helicopter."

—With Roben Farzad and Tom Lowry in New York and Eamon Javers in Washington

Kenneth G. Langone, the third co-founder of Home Depot, a member of its board of directors, and a strong Nardelli ally, said in a 2004 interview.

But among many of Home Depot's 355,000 employees, especially rank-and-file workers in its orange big-box stores, there was little sympathy as Nardelli dug himself into a deeper and deeper hole. They resented the replacement of many thousands of full-time store workers with legions of part-timers, one aspect of a relentless cost-cutting program Nardelli used to drive gross margins from 30% in 2000 to 33.8% in 2005. As the news of his resignation on Jan. 3 shot through Home Depot's white-walled Atlanta headquarters and reached stores, some employees text-messaged each other with happy faces and exclamation points. "I think that it is being received well. Most people believed that Bob was autocratic and stubborn," says an assistant manager in an Atlanta store who asked not to be named.

Possibly more devastating to his chances of a longer reign at Home Depot, Nardelli alienated customers just as thoroughly as he did employees. Staffing cuts led to persistent complaints that there weren't enough workers in Home Depot's cavernous stores to help do-it-yourself customers. That was a marked change from the era when Blank and Marcus, who started the company in 1978, preached that employees should "make love to the customer." In 2005, Home Depot slipped to last among

the type of person we need," says a former senior executive. Managers who weren't hitting their numbers—"making plans" in Home Depot parlance—were routinely culled, their positions often filled with former executives from GE. That led some later insiders to dub the company "Home GEpot." In fact, since 2001, 98% of Home Depot's top 170 executives are new to their positions; 56% of the changes involved bringing new managers in from outside the company.

Nardelli's relationship with Wall Street analysts was only just as frayed. He chafed at their constant focus on "same-store sales," a standard retail measurement that tracks sales at stores open at least a year. In Nardelli's view, same-store sales was an out-of-date metric because Home Depot was diversifying away from being strictly a retail operation. Under his leadership, the company has invested more than \$7.6 billion to build Home Depot Supply, which provides service to professional contractors. With \$3.5 billion in revenue in the third quarter of 2006, up 159%, HDS accounted for 15% of total Home Depot sales. In Nardelli's view, this successful new unit can't be accurately measured on the basis of same-store sales.

Credit Suisse First Boston analyst Gary Balter says Nardelli didn't get along well with Wall Street because he was unhappy with analysts' skepticism of the move away from consumer retailing and into servicing professional contractors.

"He blamed a lot of his problems on Wall Street," says Balter. "Wall Street wanted to see results and they just weren't there."

The lack of results, at least in terms of an improving stock price, gradually stirred anger

among shareholders. Speculation mounted late last year that Home Depot could be a prime target for private equity firms hungry for retail assets. While the company spent \$20.3 billion to buy back shares and issue dividends under Nardelli, investors saw almost no gains in their share value. Their frustration was exacerbated by Nardelli's eye-popping pay package: more than \$200 million in salary, bonuses, stock options, restricted stock, and other perks over the last six years.

Last month, activist investor Relational Investors shared its criticism of Home Depot management and called on the board to form a special committee to review the company's direction, even the possibility of a sale. Relational attributed Home Depot's difficulties to "deficient strategy, operations, capital allocation, and governance." After the announcement of Nardelli's departure, a source familiar with Relational called the departure "a positive" but added that "the major strategy, capital, and management

“You can't s---t on your employees and deliver” results. SHAREHOLDER A. LEIGH BAIER

major U.S. retailers in the University of Michigan's annual American Consumer Satisfaction Index. To try to make amends, Nardelli announced a plan in August to add 5.5 million man-hours back to stores and invest \$350 million to spruce up aging outlets. "Bob Nardelli is a smart man, but he doesn't need to be in a high-profile business like retail," says a former top Home Depot executive. "He needs to be in manufacturing, a business that does not have such consumer attention."

Indeed, Nardelli's data-driven, in-your-face management style grated on many seasoned executives, resulting in massive turnover in Home Depot's upper ranks. Former chief marketing officer John H. Costello, a retailing veteran from Sears Holding Corp., quit in late 2005, and Carl C. Liebert III, the executive vice-president who oversaw store operations, resigned last October. "He would say that you're just not leadership material, you're just not Home Depot material, you're just not

devil's advocate

evangelist

'BEING MEAN IS SO LAST MILLENNIUM'

BY DIANE BRADY

When Robert J. Nardelli and James W. McNerney lost the horse race to succeed Jack Welch as head of General Electric Co., the two men had very different reactions. McNerney immediately swallowed his disappointment and told Welch that he had picked a great guy in Jeffrey R. Immelt. A devastated Nardelli pressed Welch to know why he didn't get the job. Didn't he have the best numbers? What did Immelt have on him? Why wasn't he the guy? The bitterness was palpable, say insiders.

Both moved on to lead underperforming companies. McNerney, 57, jumped to 3M Co. and then Boeing Co. An angry Nardelli stormed into the top job at Home Depot Inc. Both received big pay packages and delivered impressive numbers. But that's where the similarities end. While McNerney nurtured an environment of respect at his companies, Nardelli's tenure was marked



McNERNEY Boeing's Dale Carnegie

by callousness and heavy-handedness. In the end, he couldn't even entertain a symbolic pay cut imposed by his board. "Being mean is so last millennium," says advertising guru Linda Kaplan Thaler, who co-wrote *The Power of Nice*.

Consider how the former GE rivals approached their new jobs. Nardelli arrived

at Home Depot full of bombast, standing up at one meeting to say "you guys don't know how to run a f---ing business," according to a former senior executive at Home Depot. In contrast, McNerney spent his first six months at Boeing talking to employees to better understand the businesses. He didn't yell or publicly humiliate anyone. And though the aerospace giant was reeling from a binge of corporate misconduct, McNerney didn't stuff the top ranks with his GE pals—as Nardelli did. He called for teamwork and heaped credit on shunned CEO contender Alan Mulally. A modern-day Dale Carnegie, he even remembers low-level staffers' names. "Jim's problems have been as tough, or tougher, than the ones that Bob had to face," says a former GE peer. "But he has tried to solve them in a much more pleasant way. The guy is loved over there at Boeing—and that's got to make a difference."

With likability a buzzword among CEO headhunters, it can make all the difference. Nardelli clearly cared about Home Depot. When it came to measures like profitability, his push was paying off. What he neglected was the touchy-feely stuff: the enthusiasm of his people, a sense of humility before his board, the care and feeding of his shareholders. It all seems so soft and irrelevant, until the injured egos decide to fight back.

at issues remain. Fresh new blood remains an objective." It wasn't only activist investors like Relational who had grown tired of Nardelli's leadership. He irritated Atlantaers, too. In a Nov. 25 letter to Nardelli, reviewed by *BusinessWeek*, A. Leigh Baier, an Atlanta attorney and Home Depot shareholder, requested that the company's board include a non-binding resolution in Home Depot's proxy statement asking shareholders to vote on whether "they are in favor, or opposed to, the board of directors of Home Depot terminating the contract." Explaining his now-moot proposal, Baier says, "I can't s---t on your employees and deliver" results.

Others remain outraged, even with Nardelli gone. A group of unions whose pension funds own shares in Home Depot plans to challenge his \$210 million payout at the annual meeting in May. Meanwhile, in Washington, Representative Barney Frank (D-Mass.), the incoming chairman of the House Financial Services Committee, said in a statement on Jan. 3: "The actions of Home Depot's Board of Directors to simultaneously dismiss Robert Nardelli and provide him with \$210 million in severance is further confirmation of the need to deal with the pattern of CEO pay that appears to be out of control."

It's unlikely Home Depot's new chief executive, Frank Blake,

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will change the Nardelli-driven demand for data and centralized control. A former Deputy Energy Secretary and GE veteran, Blake played a key role in executing Nardelli's strategy at the retail chain. But company executives say he lacks Nardelli's sharp edges and prefers to build consensus rather than dictate orders. While Blake is an unknown to many Home Depot employees, the Nardelli departure was already brightening the mood at some company stores. "It's amazing the reaction of people on my floor. People are openly ecstatic. High-fiving," said an Atlanta store operations manager only hours after the Jan. 3 announcement. "There's a group talking about going to happy hour at noon."

Corporate America hasn't seen the last of Bob Nardelli, however. According to people familiar with the situation, while store workers were celebrating, the former CEO was

already fielding calls from private equity firms interested in his formidable operational talents (page 90). The bright side for Nardelli in the world of privately owned corporations, course, is that he won't have to deal with any annual meeting or shareholder questions.

—With Dean Foust in Atlanta; Emily Thornton, Rol Farzad, Jena McGregor, and Susan Zegel in New York; and Eamon Javers in Washington

BusinessWeek .com For a profile of Home Depot's new CEO, Frank Blake, and a look at how GE alumni have fared at other companies, go to businessweek.com/extras.

For a podcast interview by Executive Editor John A. Byrne with Atlanta Correspondent Brian Grow go to businessweek.com/podcast.

A SHARPER EDGE FOR LOWE'S

BY BRIAN HINDO
AND NANETTE BYRNES

By many benchmarks, including sales, gross margins, and profits, Bob Nardelli did a fairly good job at Home Depot. Don't be surprised if his successor has a hard time measuring up to the same financial standards. The next leader of America's biggest home improvement store faces a deteriorating housing market. And the new honcho will have to execute just as Home Depot's archrival Lowe's Companies ramps up its assault on the Atlanta company's bread-and-butter business.

Despite the continued weakness in the homebuilding market and a 7% decline in its once-gravity-defying share price in 2006, Lowe's Chief Executive Robert A. Niblock, is forging ahead. The Mooresville (N.C.) company wants to open 155 stores this year, on top of 155 in '06, bringing its total close to 1,500. (Home Depot now has 1,854 stores in the U.S., and several hundred more abroad.) And Lowe's is targeting big markets, particularly cities in the Northeast, Florida, and California, traditional bastions of strength for Home Depot. A key metric is the companies' sales per square foot; Lowe's total is about \$100 less than Home Depot precisely because it has yet to saturate those lucrative markets packed with boomers who have money to spend on their aging homes.

"We're investing now, and we'll be well-positioned for the future," said Niblock, 44, in an interview on Jan. 3, the day of Nardelli's resignation. He professed little interest in the shifts taking place at his rival. "The fact that there's a change in leadership won't have any impact at all on how we take care of our customers," said Niblock, who took the helm in 2005.

Lowe's already enjoys a far better reputation. It has consistently won plaudits for having a more appealing store design—especially from women shoppers. According to the 2005 American Customer Satisfaction Index, Home Depot ranked worst among specialty retailers, while Lowe's satisfaction rating was second only to Costco. (In 2001, as Nardelli's tenure began, Lowe's and Home Depot were tied.) That's the competitive advantage Niblock expects to wield as Lowe's moves more directly onto Home Depot turf.

I think this announcement may give [Lowe's] additional opportunity."

CITIGROUP ANALYST DEBORAH WEINSWIG

Home Depot's tumultuous year, capped by Nardelli's exit, gives Lowe's an enticing opportunity to make good on its plans. In 2006 two other top executives left Home Depot. With Nardelli gone, the management team is suddenly inexperienced and not very deep. Lowe's, by contrast, has what Citigroup analyst Deborah Weinswig considers one



GARDEN CITY, N.J. A Northeast push

of the most well-established and vibrant executive suites in retailing. "I think this announcement may give them additional opportunity," says Weinswig, who rates Lowe's her top stock for 2007. "You'll have enough management turmoil and people taking their eye off the ball" at Home Depot.

That's not to say Home Depot's outlook is bleak. The company's stock, stagnant during Nardelli's six-year reign, has long been considered undervalued on Wall

Street. Shares rose 2.3% on Jan. 3, to their highest level since May, on the news of Nardelli's departure. Ivan Feinseth, managing director at Matrix USA, has "strong buy" ratings for both Home Depot and Lowe's. But he's markedly more enthusiastic about Lowe's. "The difference is customer service, experience, and product offerings," he says.

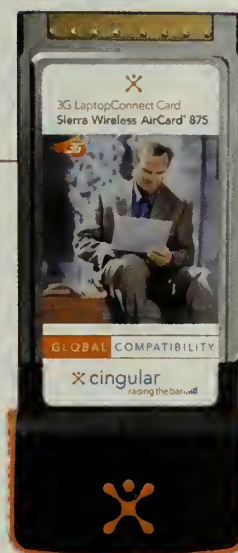


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He's Making Hay As CEOs Squirm

Erik Lie uncovered widespread backdating of stock options. Now he's reaping rewards

BY PETER BURROWS

ERIK LIE LOVES ACADEMIC life. The University of Iowa associate finance professor is free to research whatever topic intrigues him, and his \$160,000-plus income goes a nice long way in Iowa City. Summers off mean that Lie (rhymes with "key"), his wife, and two kids can travel back to his parents' vacation home in Norway. During the rest of the year, he's free to take off after class for a run or some cross-country skiing. "Life as a professor is good," says the lanky 38-year-old.

It's particularly good now that Lie's research is having a major impact on Corporate America. His mid-2005 research first suggested that hundreds of companies may have routinely manipulated stock-option accounting rules to sweeten top executives' paydays. A later study done with his research partner, Indiana University associate professor Randall Heron, puts the number at 2,000, or 29% of all public corporations. Five executives face criminal indictments for such alleged backdating, more than 100 companies face civil charges and shareholder suits, and hundreds more are neck-deep in comprehensive investigations of their books to try to make sure the Feds don't add them to the list.

The scandal is creating a financial windfall for Lie. He and Heron have created a limited partnership now that the initial crush of calls from reporters has given way to people willing to actually pay for their insights. Lie says he has earned around \$100,000 from hedge funds and other investors, who pay him to handicap whether a company's options irregularities are harmless paperwork errors or the kinds of fraud that lead to CEO ousters and big civil penalties. He'll probably draw \$400 an hour or more doing consulting work for law firms, and still more as an expert witness. He's now

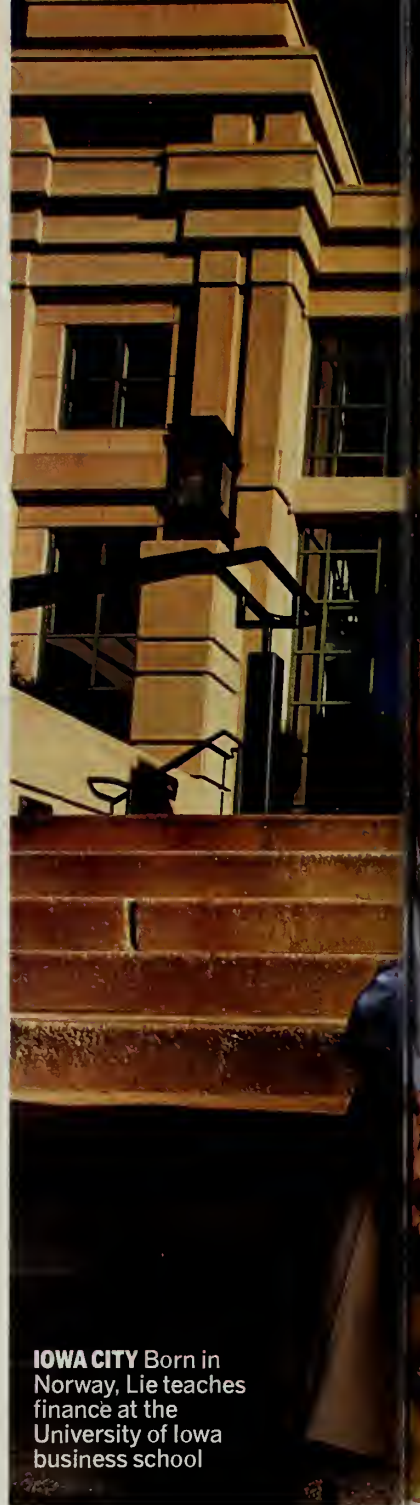
a senior adviser at the Brattle Group, a consultancy in Washington. All told, Lie figures he could make \$250,000 before the options scandal fades from memory.

Lie may be underestimating his prospects. An elite business prof can make tens of thousands for a one-day consulting gig. Notre Dame University professor Paul H. Schultz, who in the mid-1990s discovered that NASDAQ market makers were skimming pennies from investors on stock trades, says he earned \$250,000 over three years, charging \$250 an hour to work with plaintiffs' attorneys. "But Erik can do quite a bit better, if he wants to," Schultz says. "There are more lawsuits, and he should be charging a higher rate."

LUCKY TIMING?

RARELY HAS AN academic had such an outside, real-time impact on the business world. Academics had long known that companies tended to grant options with remarkable acuity—just before big rises that gave those options immediate value, at least on paper. But Lie and Heron were first to suggest that this could only have happened with the help of hindsight. That's because those favorable trading patterns appeared only in cases where companies had delayed their options paperwork for months, giving them the ability to look back and cherry-pick the most lucrative grant dates. That's a violation of federal law—and of many corporate options plans—if not properly disclosed.

Lie helped make sure the scandal exploded, notifying the Securities & Exchange Commission of his work and showing *The Wall Street Journal* how to interpret a particular company's options records, although he insists he never I.D.'d companies himself. He's clearly proud of his work's resonance but insists the attendant financial opportunities are a low priority. He limits his consulting



IOWA CITY Born in Norway, Lie teaches finance at the University of Iowa business school

time, he says, to less than one day a week. "I did not start this line of research for the money, and I am still not in this for the money," Lie says.

Now he's turning away many opportunities, he says—particularly from plaintiffs' lawyers who would like to tailor findings to suit their cases. But he is being "less pushy" plaintiffs' attorneys prepare potential cases against three do companies, diving into details of spec transactions. Indeed, he says he'll probably take the stand as an expert witness some high-profile cases. He won't na



How Lie Is Cashing In On Options

University of Iowa professor Erik Lie has been hailed for helping expose the widespread abuse of accounting rules for granting options. Now he's profiting from his academic insight.

ADVISING INVESTORS

Lie has offered advice on 100 or so companies. Investment groups come to him to get a sense of the seriousness of a particular company's irregularities.

ASSISTING PLAINTIFFS' LAWYERS

Lie is helping plaintiff firms build cases against three dozen alleged backdaters. He expects to serve as an expert witness in several such cases, assuming they aren't settled first.

DEFENDING ACCUSED BACKDATERS

Lie hopes to find work helping companies that he thinks are innocent defend themselves in court. So far, however, he has not found any takers.

Data: BusinessWeek

like that people have gotten money they didn't deserve," says the elder Lie. The son briefly considered a career in law but later caught the academic bug while doing a finance research project at the University of Oregon.

SERENDIPITY

WHEN HE BEGAN researching stock options as a young professor in 2002, it wasn't to find a scandal. "Shareholders were giving executives options so they'd work harder to change corporate behavior," he says. "I just wanted to see how it manifested itself"—say, by companies repurchasing more shares. Even after Lie began to suspect backdating, it took a while for anyone to listen. An initial paper in 2004 was slammed by a reviewer who said that Lie was "overreaching" and that his conclusions "made little economic sense." After Sarbanes-Oxley regulations were imposed, however, all option grants had to be reported to the SEC within two days. By comparing the new grants with pre-SarbOx grants, Lie and Heron were able to document a disappearance of the windfall obtained by execs at companies that had taken months to file in the past.

Defense lawyers dismiss Lie's analysis because it doesn't consider legitimate explanations for how options may have been granted at low stock prices. For example, CEOs during the boom routinely granted options on days when their stocks were down because of unfounded rumors. That way, they could provide some extra incentive to employees before cranking up their investor relations efforts to refute the rumor. "His analysis is simplistic," says Richard Marmaro of Skadden, Arps, Slate, Meagher & Flom, who is representing indicted former Brocade Communications Systems CEO Greg Reyes. "There are people whose job it is to grant options, who are expert in understanding what they perceived to be low prices."

Lie says he's going into this next phase of the scandal with his eyes wide open, expecting to have his motives criticized, and ready for persuasive arguments about why a specific company, board, or executive did nothing wrong. He figures that the bulk of backdaters have yet to be identified, and that just 10% will ever be punished in any way. "I don't anticipate I'll be able to create something of this magnitude again," he says. "But it's not necessary for me that there is a consequence for every single firm. My research has already helped curb this behavior. That's the most important thing." ■

names, in part because it's too early to know which companies will settle rather than make it into court, but does say that "they may become involved in litigations" such as Apple Computer (page 28).

Lie is also open to working with defendants facing options-related allegations, although none have taken him up on the offer. "People tend to think I'm not at all companies," he says, "but I am some of the companies identified in the media as innocent"—perhaps a dozen or so of the 200 companies that have announced options irregularities.

He says some guiltless CEOs are likely to lose their jobs simply because they were at the helm when mistakes were made by others. Still, "it's one of those necessary evils; a small price to pay to get more transparency into the system. How much is good governance worth to the economy? I don't know, but it's billions and billions."

Lie grew up the son of left-leaning parents in southern Norway. His father, Rolf, a retired construction engineer, thinks Lie is imbued with the economic egalitarianism they taught him. "Erik doesn't

China: Falling Hard for Web 2.0

Youngsters are flocking to homegrown versions of MySpace and YouTube

BY BRUCE EINHORN

IT WAS THE SORT OF BREAK most Net startups would die for. Chinese TV actress Zhang Yu said notable directors had made her audition on the “casting couch” before giving her roles. To back up her claims, Zhang in November posted videos of two encounters on a Web site called Yoqoo, one of dozens of Chinese YouTube and MySpace wannabes. Thanks to the racy footage—heavily edited to keep things from getting X-rated—traffic on Yoqoo tripled to about 7.5 million video streams a day.

But in China, Yoqoo had little chance to capitalize on the publicity. Shortly after the videos went live, Yoqoo—which is pronounced “yo ku” and means “good” and “cool” in Chinese—got a quiet but firm warning from the government’s Net cops. “Relevant authorities indicated that this has gotten so much public media attention that it would be helpful for us to remove the videos,” says Yoqoo founder Victor Koo. While he insists “there was nothing pornographic” about the content, Koo quickly complied.

The episode shows the promise and the peril of user-generated content and social networking in China: You can get monster traffic with the right video, but you could get in big trouble for showing it. Still, the mainland remains fertile ground for so-called Web 2.0 startups. The country has more than 130 million Internet users, up 30% in 2006. To serve them, China has sprouted scores of homegrown companies hoping to become the next MySpace, YouTube,

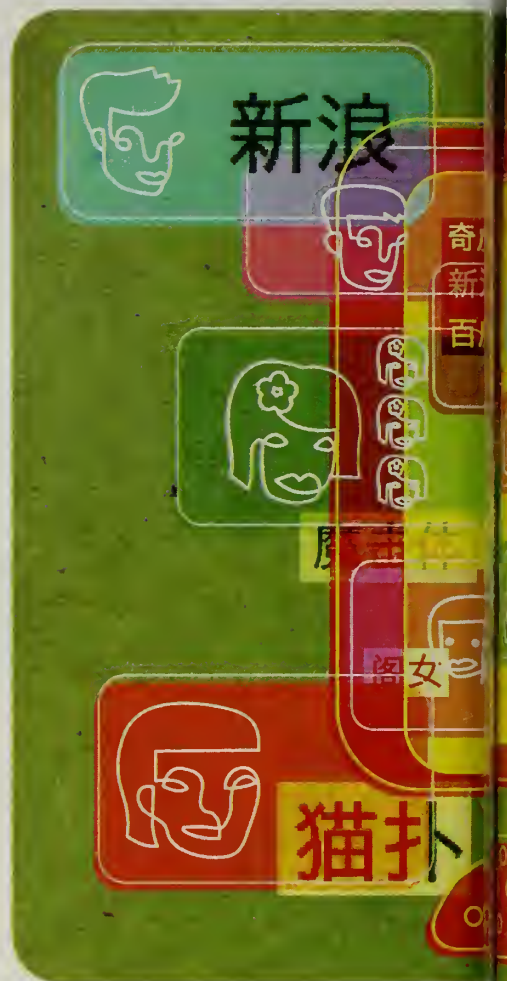
or Digg. Soon they’ll be joined by the real thing. News Corp.’s MySpace is in negotiations to set up a Chinese-language version of the social-networking phenomenon. And Google is taking a stake in video-sharing site Xunlei.

BOTTLED UP

CHINESE TEENS AND twentysomethings, brought up on the bland fare doled out by state-controlled media, are flocking to these sites. “You have this pent-up energy,” says Eric Feng, the 28-year-old founder of Mojiti, a Beijing-based startup that allows users to add text and graphics to video clips. “They want to express themselves, but they have so few outlets to do it,” says Feng. That desire for self-expression has spurred the explosion of sites specializing in sharing

music, videos, pictures, and writing.

U.S. investors like the sites. Greenwich (Conn.)-based General Atlantic last March plowed \$48 million into Oak Pacific Interactive, the Beijing holding company that operates Mo.com, China’s most popular social-networking site. Qihoo, which specializes in searches of blog postings, got \$25 million in November from Sequoia Capital, Redpoint Ventures, and Highland Capital Management. MySpace founder Brad Greenspan invested in or formed partnerships with more than 20 Chinese sites through his company BroadWebAsia.com. A big reason for the interest: Web startups don’t have to spend a lot of money developing expensive content that pirates can rip off, says Bill Tai, a partner in Menlo Park, Calif., Charles River Ventures, which has backed WangYou, a Beijing startup. “There is no proprietary technology,” Tai says.



The New Socialism

Some of China's top Web 2.0 sites

WANGYOU MEDIA This site, with financial support from VC Charles River, focuses on music and video for young people

TUDOU One of the first video-sharing sites, this Shanghai company has backing from International Data Group

YOQOO In December this Beijing startup raised \$12 million from Sutter Hill Ventures and others

XUNLEI Google has a stake in this video-sharing company based in Shenzhen

QIHOO Specializing in searches of blog posts, this startup is supported by Sequoia Capital and other prominent VCs



it's shifting the risk profile in a very
ive way."
at as locals and foreigners alike
dy learn, there are still plenty of
to Web 2.0 operations in China. In
U.S. a naughty video might anger a
parents or religious groups; in China,
tamer clip could spur censors to
down your company. While YouTube
torts videos for pornography and vio-
ns of intellectual property, in China
self-censorship goes much further.
instance, WangYou gets about 6,000
files a day, and the company can't
d to let a single one go live without
eing it first. "All of this content has
e screened and scrubbed before it
uploaded to the Web site," says Chief
ncial Officer Edward Haynes, a 42-
old Long Island native who worked
banker at HSBC before helping to
h WangYou in 2005.

PEAKY CLEAN

OTHER COMPANIES, WangYou has
us ways of keeping the peace with
authorities. Users must pledge to
by its rules, which include bans

on pornographic and anti-
government materials. A
team of about two dozen
in-house censors screens
videos 24/7, and users
who flag problematic clips
posted by others are re-
warded with points that
can be redeemed for good-
ies such as ringtones. But
for many, the reward is
simply the ability to con-
tinue posting to the site. Users "don't
want their community to be destroyed
by somebody putting up inappropriate
content," says Buddy Ye, WangYou CEO
and co-founder.

Happily for Ye, most of his clients
seem more interested in sharing mu-
sic, photos, and poems than political
ideas. One WangYou fan is 28-year-old
Li Mengyang. A producer at a Beijing
TV station, Li has posted 200 of his own
songs, plus some short stories, on the
site. In early 2006 he also began hosting
a WangYou literary discussion group. Li
says he is happy that taboo postings are
filtered out: "I don't want to see that." He

Censorship and a soft ad market remain problems

adds that despite the censorship, there is
more freedom online than at his day job
in television, "where some creative ideas
simply can't make it" because program-
ming chiefs are afraid of turning off con-
servative viewers.

Keeping the censors happy is rela-
tively easy; finding a way to make money
is harder. China's online ad market is ex-
pected to total just \$800 million in 2007,
vs. some \$19 billion in the U.S. To boost
revenues, video-sharing site Mofile.com
is developing software that can deliver
video recommendations—and commer-
cials—based on users' earlier choices.
"We can figure out what kind of TV
commercial you would be interested in,"
says founder Andy Fan. Mofile, which
has about 6 million registered users and
shows some 4,000 videos a day, hopes to
launch the new service in early 2007.

CELL SURFING

OTHER SITES ARE looking to connect
with China's 400 million cell-phone us-
ers. WangYou, for instance, lets people
send photos from their Web pages to
handsets, and gets a cut of the call charge
from the phone company. Because China
has so many more mobile-phone sub-
scribers than Net surfers, sites that target
PC users "may lose out to companies
who have worked harder on social net-
works through the cell phone," says
Timothy C. Draper, founder of Silicon
Valley venture capital firm Draper Fisher

Jurvetson, which invested
in mobile social network
eFriendsNet.

Despite the deep pock-
ets of MySpace owner
News Corp., Chinese Net
executives say they're not
too worried about its ar-
rival. U.S. Internet compa-
nies, after all, haven't fared
particularly well in China.
Yahoo!, Amazon.com, and

Google have been outmaneuvered by
local rivals, and eBay Inc. on Dec. 19 an-
nounced it was shuttering its Chinese site
and forming a joint venture with Beijing-
based Tom Online Inc. Given that track
record, and the potential for missteps
in handling the censors, locals may well
have an edge, says Joseph Chen, CEO of
Oak Pacific, which controls six Web 2.0
sites. What keeps Chen up nights are not
thoughts of U.S. marauders but the ever-
expanding hordes of homegrown rivals.
"We've heard of 50 MySpace copycats
and 150 YouTubes" in China, says Chen.
"That's what we have to deal with." ■

—With Olga Kharif in Portland, Ore.

Can Seagate Make Disk Drives Sexy?

With new products and an ad blitz, it aims to climb out of the commodity bin

BY CLIFF EDWARDS

IT TOOK JIM DRUCKREY, THE new head of consumer products at Seagate Technology, nearly a year, a half-dozen trips to Asia, and a thick binder's worth of research to confirm something that any PC user could have told him: Disk drives may be the duller product on the planet. The result is that while Seagate sold nearly 120 million disk drives and other data-storage devices last year, it had no iPod or Xbox 360 in its lineup—nothing to excite consumers into paying a little more for Seagate products than for the competition's.

That's where Druckrey, former president of the digital business of Gibson Guitar Corp., comes in. On Jan. 7, Seagate plans to announce a new family of products called FreeAgent that it will sell directly to consumers as a way to ensure that the pictures, music, and other digitally stored pieces of their lives don't disappear in a blink of an eye. Druckrey, who used to rub shoulders with musicians Les Paul, José Feliciano, and Madeleine Peyroux, will then have to persuade PC users that storage is sexy—and necessary. "This has always been a low-involvement, boring category, and it's important for us to create something dynamic and tangible for people to understand," he says.

DRUCKREY The new consumer chief is buying or teaming up with software makers

Seagate is coming to grips with an increasingly common challenge in Silicon Valley: how to turn a profit with cutting-edge technology in a world where consumers increasingly care less about whiz-bang features and more about what they actually do. The Scotts Valley (Calif.) company commands a third of the market for hard drives, but nearly 97% of those drives are sold to computer and consumer electronics makers for use inside PCs, TiVos, and other gear.

Thus, disk drives may be the ultimate tech commodity. Consumers soon will be able to store a terabyte of data on a single drive, thanks to advances rivaling those of chipmakers. But because there are so many competitors, drive margins hover near 6% as prices spiral lower. Meanwhile, Intel Corp., whose "Intel Inside" campaign created the impression that its microprocessor is the single most important



PEACE OF MIND
Seagate calls its FreeAgent line "data movers"

PC component, enjoys 50% margin. Seagate CEO William D. Watkins believes he needs a thriving consumer business if he's going to reach his goal of nearly doubling Seagate's revenue to \$20 billion, in just three years. Watkins hired Druckrey in November, 2001, after a first attempt at sprucing up consumer designs ended in failure. Seagate's Pocket Drive, a palm-size portable gadget that plugs into a PC to let you back up pictures and files, won numerous design awards for its hockey-puck look. But it was returned to stores in droves

because consumers mistook it for a digital music player. "We showed us we didn't have a clue what we were doing in consumer," Watkins says. "Before [hiring] Druckrey, we were a bunch of people who were doing disk drives and client servers designed for performance and not what the consumer would do with them."

FreeAgent aims to address those failings. Rather than emphasize external backup, Seagate will call these products "data movers" and

emphasize their ability to manage content anytime, anywhere instead of just saving it. Seagate has bought or teamed up with software makers to enable users to automatically transfer files to a FreeAgent drive, copy e-mail and contacts from Microsoft Outlook to an iPod, and automatically load and access favorite photos from a Shutterfly account. A high-end version of FreeAgent also will offer free online data management, similar to efforts from Amazon.com and Google.

Getting to this point hasn't been easy. Druckrey practically had to beg advertising agency TBWA\Chiat\Day to take the Seagate account. "Here's an industry that worshipped the hard drive by presenting pictures of it cut open to consumers," notes Rob Klingensmith, the agency director of strategy. Designers from San Francisco's frog design found ways to stuff new high-density storage technology into thin black casings ranging in size from a matchbox to a large stapler. By producing in China, Seagate thinks it can squeeze 25% margins out of drives selling for \$130 to \$420.

Next up: an ad blitz to convince people they need such a product. That might prove to be the toughest sell of all. Right now, only 14% of consumers back up their data each week against possible crashes. ■



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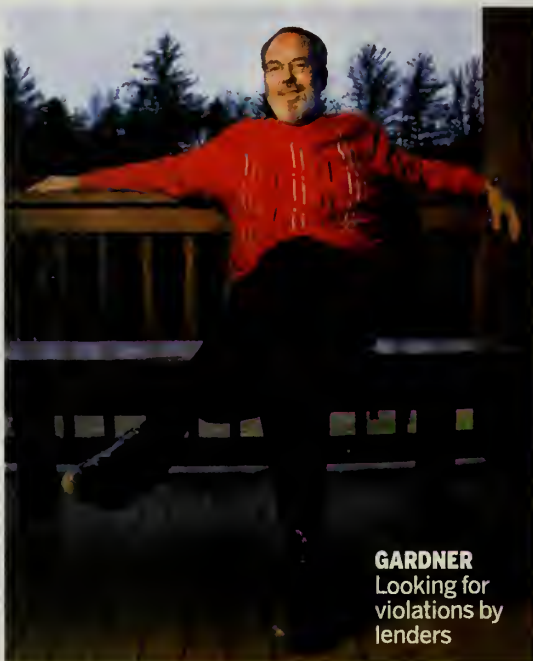
BY MARA DER HOVANESIAN

EVERY WEEK AT LEAST two homeowners walk into the office of Boston bankruptcy attorney David G. Baker looking to get out from under their mortgage debt. That's an alarming increase for a sole practitioner like himself. "I've never before had clients who walk in and say: 'I just can't afford my house anymore,'" he says. "It's a little scary."

Baker needed to bone up on the intricacies of new mortgage products. So he signed up for Bankruptcy Boot Camp, the brainchild of O. Max Gardner III, the go-to guy for consumer bankruptcy attorneys across the country. The idea is to get lawyers familiar with the latest strains of mortgage abuse, then to educate them about federal laws that protect their clients. Baker now knows how to renegotiate mortgages and avoid a foreclosure. "People can ask lenders to restructure their loan," he says. "But that's something they keep from you because it's not in their best interest."

Since Gardner launched the program in August, 82 attorneys have attended the 12-hour-a-day, four-day program held at his 160-acre Lizmere Farm in western North Carolina. It's a family operation: Gardner is the only instructor, and his wife does the cooking. He charges \$7,775 a pop, but the lawyers don't seem to mind. Says Kathy Cruz of the Cruz Law Firm in Hot Springs, Ariz.: "It wasn't anything like law school. Boot Camp teaches what you need to know in the trenches."

It sure helped Frank H. Coxwell, a consumer lawyer in Jackson, Miss. Even though he's been practicing for 30 years, Coxwell says he's now able to recognize violations he didn't know existed before going to Boot Camp. Since attending the first session in August, he has 140



GARDNER
Looking for violations by lenders

Combat Rules

Advice for attorneys representing possible victims of mortgage abuse:

- Don't let the creditor's lawyers intimidate you. They're afraid of court, judges, and especially juries.
- Don't limit your knowledge to the Bankruptcy Code. Know how to use all of the federal and state consumer protection laws.
- Don't file a case unless you're ready to try it the next day.
- Don't flood the courts with cases. Pace yourself and educate the judges.

cases headed for court, some of which were files he reviewed with a new eye. "Everyone always assumed that foreclosure was the debtor's fault," he says. "The lawyers, the judges, everyone has to be reeducated. You can't believe what

we've caught [lenders and mortgage servicers] doing."

It's inevitable that some homeowners get hurt in a downturn, especially those who have to sell unexpectedly and can't ride out the market. But experts say the pain will be broader and deeper than the time around. In the past few years, millions of Americans bought homes they couldn't afford, lured by exotic mortgages that advertised no money down and low monthly payments—for a limited time only. As housing prices crashed and interest rates rose, borrowers were squeezed. The result: One in five prime loans issued in 2005 and 2006 will fail, according to the Center for Responsible Lending.

ON THE OFFENSIVE

GARDNER AND HIS growing cadre of lawyers say the lending system is largely to blame. While some people carelessly got in over their heads, lenders bear responsibility for extending too much credit to unsophisticated borrowers. When abusive players fail to collect mortgage payments, they charge huge late fees. Before the Bankruptcy Reform Act of 2005, most attorneys just did the necessary paperwork to work out the inevitable Chapter 13 plans. But Gardner's model advocates scouring for violations that occur during the lending process and when the borrower is in bankruptcy protection. "My goal is to train an army of attorneys to take fight right to the creditors and their Wall Street aiders and abettors," says Gardner. "I wanted reform, and we're going to give it to them."

The 61-year-old Southerner relishes battle with "tall-bill lawyers"—public servants in his blood. He's the grandson of O. Max Gardner, a former North Carolina governor and U.S. ambassador to Great Britain under Harry S. Truman. His grandfather pushed through a workers' compensation bill during the Great Depression.

As a state senator, he broke a tie and won the vote, and he was among the first employers in the South to hire African Americans in his textile mill in 1911. "He was severely criticized for being says Gardner. ■



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A STAR ALLIANCE MEMBER

Click for Foreign Labor

Companies are using online middlemen to find legitimate unskilled workers

MOIRA HERBST

WHEN SHE COULD not find enough workers for the construction firm owned by her son Thomas, Ann Carroll decided to go online. After typing in such search terms as "construction laborer" and "Mexican workers," she landed on the Web for Labormex Foreign Labor Solutions. Within days she had a quote: \$100 for 11 Mexican workers and \$1,340 over the visas. In October, Carroll Construction Co.'s recruits began laying sewer pipes in Ocean Springs, Miss., where the company is located. "I don't know what we would've done if we didn't have this route," says Carroll. "We're very happy with the workers."

amid a federal crackdown on illegal immigration—including the December seizure of 1,282 Swift & Co. meatpacking workers—and a roiling political debate over expanding guest-worker programs, companies are turning to online middlemen to find legitimate foreign laborers. Websites such as Monster.com and CareerBuilder.com have been helping companies scour the globe for white-collar workers since the late 1990s. Now unskilled workers, too, are a few clicks away, a boon for such chronically labor-starved industries as construction, agriculture, and catering.

With all things Web-based, there are shady characters hoping to cash in on immigration. "We are hard-pressed to find the scores of Web sites that have popped up in recent years. 'The Internet' has opened up channels for both legitimate and fraudulent recruiting," says Eli M. Kan-

tor, a veteran Beverly Hills immigration and employment lawyer. "There's not much regulation of [online] recruiting."

But as Carroll's experience shows, using a legit online middleman can be efficient and cost-effective. Labormex was founded in 2002 by Seymour Taylor, an entrepreneur descended from a family of American settlers in Mexico. Business took off when he set up a Web site about a year ago and began advertising on Yahoo and Google. The site boasts of "hardworking people acclimated to tough physical labor and who have worked under severe warm-weather conditions"—guys like Andreas Alcala Martinez, 29, who works for Carroll Construction. "Little money, but not hard work," says Martinez. He makes \$9 an hour and arrived on an H-2B visa, of which the U.S. issues 66,000 annually for low-skilled work. He can work for Carroll for 10 months, with the option of renewal.

MAJOR CLIENTS

NEXT TO THE BIG job sites, Labormex is a minnow. Taylor says he placed about 200 people in 2006 and expects to triple that in '07. But the company, which has offices in New York and Monterrey, Mexico, has reeled in big clients, including Super 8 Motels and the Sonic Drive-Ins fast-food chain. "Labormex has been very helpful," says Gary Wilkerson, president of Kergen Brothers Inc., which owns 40 Sonic franchises in Louisiana and has placed 25 Labormex workers in its kitchens. "Working with them has put us a step ahead of our competition."

The Labor Dept. lists hundreds of officially sanctioned recruiting agencies



on its Web site. But many online recruiters are nowhere to be found there, including latinworkers.com, ranchworkers.com, and us-guestworkers.com. The latter boasts that it can supply "high-quality workers from Nepal, where all students learn English from age 5." Founder Sandesh Prajapati says he has placed workers in Colorado and Massachusetts. When asked why his company did not appear in the Labor Dept.'s database, he said he expected it to be there in 2007.

Agency spokeswoman Peggy Abrahamson acknowledges the Labor Dept. doesn't "analyze Web sites" to determine recruiters' legitimacy. The enforcement of immigration laws falls to the Homeland Security Dept.'s Immigration & Customs Enforcement (ICE) unit. Its Cyber Crimes Center has the task of policing the Net, but ICE, citing security issues, refuses to disclose how many people are working on the issue full-time.

The online recruiters are already providing ammunition for immigration critics. "They're getting employers addicted to a supply of cheap labor and lowering incentives for them to look for domestic workers," says Jessica M. Vaughn, a senior policy analyst at the Center for Immigration Studies, which opposes expanding guest-worker programs. But with many Americans unwilling to mow lawns, build houses, and wait tables, many companies see online recruiters as a necessary way to tap a labor pool that is increasingly global. ■

MISSISSIPPI

Mexicans recruited by Carroll start at about \$9 an hour

The Labor Dept. keeps a list of officially sanctioned recruiters

Inside a White-Hot Idea Factory

Some big names are turning to upstart Fahrenheit 212 to dream up new products

BY BURT HELM

FOR SEVERAL YEARS SPIRITS giant Diageo rode high on the popularity of its Smirnoff Ice beverage. Then consumers got bored, and the party was over. Try as it might, the No.1 global liquor company couldn't reignite sales of Ice—a crucial part of its Smirnoff brand. So Diageo turned to Fahrenheit 212, a tiny New York outfit that promises to help clients dream up hit products and services. Fahrenheit listened, then disappeared.

The firm reemerged with some startling advice: Forget the Smirnoff Ice brand for now. Instead, Diageo should use its malt technology to create wildly different Smirnoff drinks. Among Fahrenheit's 10 or so fully realized products: Smirnoff Raw Tea, which appeared in August, and Smirnoff Source, an alcoholic water expected to launch this spring. "They're not just about ideas for the sake of ideas," says Michael Ward, Diageo's innovation chief for North America. "They realize the importance of understanding our business, because their ideas are only worth something if we can pull value from them."

Fahrenheit 212 specializes in a new approach to product development. With little to no inside knowledge of its clients, the company dives into their problems

and within months cooks up a portfolio of products it thinks will solve them. One part management consultant, one part advertising agency, and one part design house, Fahrenheit 212 attempts to deliver ready-to-go answers, including everything from an analysis of each potential market down to the design and packaging of the product itself. As companies seek to maximize efficiency by outsourcing just about everything, Fahrenheit 212 promises to serve up something most chief executives dream about: new products created from existing assets that will earn sizable revenue from untapped markets.

DISTINGUISHED PARENT

SPUN OFF FROM advertising agency Saatchi & Saatchi in November, Fahrenheit 212 expects to generate only about \$8 million in revenues in 2007. But it has signed up an impressive roster of clients. It won't disclose specifics, but Fahrenheit has come up with new applications for Samsung's LCD panels, cooked up new products for Hershey as the company moves beyond candy, and is helping NBC Universal identify new sources of revenue in the digital world.

Clients think of the firm as a way to make long-shot bets without having to use their own research and development resources. "Samsung is a lean organi-



VULETA AND PAYNE
Both are former Saatchi & Saatchi executives

zation. We can't afford to have people coming up with ideas that don't work," says Chief Marketing Officer Gregory Vuleta. "The people at Fahrenheit are very helpful because they are working on ideas that can fail—it allows you to experiment a bit." What's more, Fahrenheit ties part of its compensation to the success of a product, making it an even safer bet.

Fahrenheit was formed in 2006 as a crew of Saatchi & Saatchi executives. Mark Payne, now the company president, had been a regional account director of Procter & Gamble Co.'s business in Asia, where in the '90s he took part in rapid-fire product launches. "You'd fly into Mumbai, and you'd be out the big issues on the brand within three hours in the morning to figure out the solutions," says Payne.

PLAYBOOK: BEST-PRACTICE IDEAS

Boiling Up Innovation

Fahrenheit 212 brings an outsider's perspective to product development

FULL IMMERSION

The key is taking time to dive into the numbers. The team spends a month learning about the problem, market conditions, and assets that could help. Fahrenheit 212 finishes the phase by writing up a new brief for itself. It presents the direction it wants to go, and defines how Fahrenheit 212 should be rewarded for results.

MAKE IT 'BIG AND FAST'

New products ideally tap new pools of customers, using existing technology the client can quickly deploy them. To avoid small improvements on things the company already does. A three-man Fahrenheit 212 Ideas Development Group meets monthly and brainstorms product ideas.



ed to develop strategies for new
ls in places totally foreign to him,
on that came in handy later on.

2001, Payne was back in the U.S.,
unning account planning for P&G's
brand at Saatchi. On the side, he
i working on a new concept for idea-
product-development called "the
It was to be a group of eight people
finely honed expertise who would
marketing problems for clients in
months flat. He began using the hive
pt—putting an African storyteller, a
or, a closet organizer, and others to
on small projects for P&G. Before
Payne teamed up with a like-minded
gue named Geoff Vuleta, who was
ing transform Saatchi into an "ideas"
any that would move beyond tradi-
n advertising.

Bh men missed the days when ad
ies worked more closely with clients,

with more creative control,
too. Like many of their peers,
they fretted that advertis-
ing was becoming a com-
modified afterthought. They
wanted in on the ground
floor. Payne and Vuleta set
up a unit inside the agency
and named it after the boil-
ing point of water, when
"one degree of difference,"
says Vuleta, "can make all
the difference."

Vuleta, who is CEO, de-
cided to split from Saatchi, he says, to have
more freedom to do deals. The privately
held firm is a mix of ad veterans, brand
and design specialists, and MBAs. Each
has his specialty: Rony Zibara, a creative
director, for example, focuses on brand
image and aesthetics. Marcus Oliver, an-
other creative who came into his job inter-



JUST OUT In August
this drink appeared,
a fresh notion from
Fahrenheit 212

view with a sketch of "15 problems in my
bathroom," finds product-line holes.

The group typically takes five months
to complete a project. The first month is
an immersion process, when a Fahren-
heit business director and the group's
analyst pore over sales numbers, market
conditions, existing consumer research,
and learn about the client's businesses
and assets. Over the next two months,
the creative team, composed of Zibara,
Oliver, and Payne, develops the ideas,
then hires outside designers and en-
gineers to assess feasibility and build
prototypes. After presenting the ideas to
the client, the firm does formal market
research and focus-group testing.

Fahrenheit 212's founders devised
an unusual business model. Although
the firm collects the consultant's typical
monthly fee, the majority of its poten-
tial revenue is tied to the success of its
ideas. Each time an idea reaches a mile-
stone—the product enters a test market,
say—Fahrenheit gets a bonus. Fahrenheit
expects to generate roughly 25% of its to-
tal revenue this year from such payments.
Eventually it hopes to increase that to
two-thirds of total revenue.

Getting there will mean
beating the steep odds
against new products suc-
ceeding in the marketplace.
Quick buy-in from clients is
crucial, too. Before pitching
Raw Tea to Diageo, Fahren-
heit took the trouble of going
to a bartender/mixologist to
devise a close approximation
of how the new beverage
would taste. When Vuleta
and the gang presented it
to Diageo executives, they
passed around actual samples in specially
designed bottles. It's that attention to de-
tail that has other companies intrigued.

Guy Phillips runs the UBS division that
handles investment banking for consumer
products companies. He has begun refer-
ring clients—blue-chip companies and
buyout firms alike—to Fahrenheit to help
figure out new ways to boost organic
revenue growth as a way of increasing
a company's worth. Steering clients to
the firm, he says, "definitely provides an
edge" over other banks.

For Beth Comstock, president of digital
media and market development at NBC
Universal, working with Fahrenheit 212
requires a leap of faith. "They're a bit of
a Skunk Works," says Comstock, who
signed up Fahrenheit in December. "But
we need people who can take us to places
we can't yet see." ■

FEASIBLE...

ea must occupy a separate market
a client can deploy multiple
ultaneously. The Fahrenheit 212
ys the list to 8 to 10 products with
potential market value and brings in
signers and engineers to gauge
sibility and cost.

...AND FULLY REALIZED

Nothing wows clients more than a prototype (or
computer image) of the finished product. That
way in-house engineers and marketers spend
less time on development, moving quickly
instead to the execution phase. The client also
gets an analysis of the target market and a game
plan for pitching the product to consumers.



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NOVATIONS

throttled
tumors and heart-
healthy diet drugs

Genentech's blockbuster drug Avastin, worth nearly \$1 billion last year, kills tumors by choking off blood vessels that feed them. But cancer sometimes develops resistance to such medicines, and scientists at Regeneron Pharmaceuticals are taking an opposite approach. They're testing a molecule that triggers rampant growth of blood vessels, which wind up functioning poorly and starving the tumors. Early results suggest this approach works for tumors resistant to Avastin.

In 2000, Case Western Reserve University professor John Roth helped identify a cellular mechanism that caused heart-valve problems in patients who took the diet drug fen-phen. At the time, he predicted other drugs were likely to make the same switch. Two years later, in the January 4 issue of *The New England Journal of Medicine*, he vindicated his warning. This time, the heart troubles afflict patients who take certain drugs for Parkinson's disease. There's also some good news. Roth, now a professor at the University of North Carolina at Chapel Hill School of Medicine, says knowing the mechanism lets you avoid it. Since fen-phen was withdrawn from the market in 2007, scientists have tested other drugs that bypass the magical hot button. Arena Pharmaceuticals has one obesity drug in late-stage clinical trials. Drugs for Parkinson's and other ailments could follow the same strategy.



CRYOPRESERVATION

DO THESE CRITTERS HOLD THE KEY TO VIABLE FROZEN EGGS?

SOME FEMALE cancer patients freeze their eggs so they can try to have children if their treatments leave them infertile. But current cryopreservation techniques are so disruptive that only 1% to 5% of eggs develop to term when fertilized. For help, scientists at the Medical College of Georgia are turning to so-called water bears that grow to about 1 millimeter in length. Similar

to brine shrimp sold in toy stores as "sea monkeys," they produce a sugar that lets them shut down in time of drought and revive when water is available. The scientists injected mouse eggs with the same sugar, froze them, then thawed them. When fertilized, the eggs produced healthy mouse babies at the same rate as nonfrozen eggs in a control group. —Arlene Weintraub

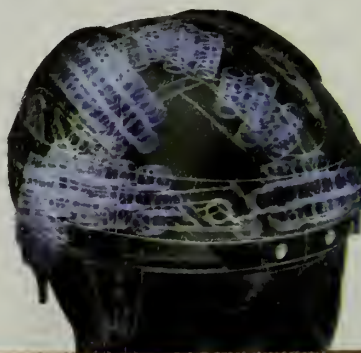
SPORTS

MAKING HEADWAY WITH HELMETS

EVEN WITH HELMETS, an estimated 40% of pro hockey players get at least one concussion each season. Cascade Lacrosse has a new helmet that increases protection in both hockey and lacrosse. In tests, it reduces the shock sustained by the brain by 40% or more, compared with current helmets. Instead

of standard plastic foam, there's a honeycomb-like material under the shell. The honeycombs are mounted to distribute an impact over a wider area. "We get significant absorption in a very small space," explains Cascade's Bob Colburn.

—John Carey



HYBRIDS

WHY PLUG-IN CARS WON'T JAM THE GRID

CARMAKERS are readying a new generation of plug-in hybrids, which come with big battery packs that can recharge at night from a regular outlet. On the road, plug-ins promise up to 100 mpg—the first 50 miles or so on the battery, and then on gas until the next recharge. Still, critics worry that a boom in plug-ins might overload the grid. And since most electricity comes from coal, they note, a switch might lead to more smokestack pollution than is eliminated from cars' tailpipes.

Not to worry, says a new study from Pacific Northwest National Labs. Without



any major changes, today's grid could meet about 84% of new demand if the U.S. fleet were switched to plug-ins. Most of the additional power would flow at night, when generators have spare capacity. And with less tailpipe exhaust, air quality in congested cities and suburbs would steadily improve. True, coal-plant emissions will rise, but it's easier to capture pollution at a single stack than from millions of cars. And growing power sales should help utilities finance cleaner plants. —Adam Aston

Thrills and Chill

Scaling frozen walls isn't for the fainthearted. But once you find your footing, ice climbing can become addictive. **BY STANLEY HORN**

SIXTY FEET OFF THE GROUND, I faced my moment of truth. I had just hauled myself up a 30-foot stretch of vertical ice and maneuvered over an awkward bulge. Breathing heavily, I stood next to two ice screws that my guide earlier had put into the frozen wall. I clipped my rope into the carabiners, or snap links, attached to these anchors.

After two days of learning how to climb vertical ice, there was no rope to catch me immediately if I fell. Now, I had to make it to the next ice screw, or anchor, without falling. If I slipped, I could drop 20 or 30 feet before the rope and the nearest ice screw caught me.

The only solution: Keep moving in a very precise and methodical way. I swung one pointy ice tool into the ice, and then stuck in the other. I kicked one crampon into the ice, moved the other one up, and repeated that motion. I tried to keep my feet level with each other and create a triangle with my feet spread apart and one tool stuck in the ice above my head. As I left the relative safety of my anchors, I kept repeating the mantra of my instructor, Chris Haaland, an Alaskan and Himalayan climbing veteran. "Remember," he said, calmly from below, "make every placement count."

What was I doing? I was learning how

to climb frozen waterfalls at the Ouray Ice Park, nestled in a breathtakingly beautiful box canyon deep in Colorado's San Juan Mountains. The canyon boasts nearly 200 steep ice climbs along the sheer red and brown serpentine walls of the mile-long Uncompahgre Gorge. The ice is formed by a sprinkler system that runs parallel to the gorge and taps into a water source above town. Every winter night, the sprinklers spray over the edges of the gorge so ice forms on the walls.

The ice park and the mid-January Ouray Ice Festival draw visitors around the world to this onetime mountain town. "This has grown from a handful of climbers in the mid-1990s to 20,000 to 30,000 climbers visiting over the course of the winter," says Erin Eddy, president of the ice park board. Climbers enter the park above the gorge, then descend the steep trails to the bottom of the canyon walls—which range between 70 feet to 200 feet high. The climbing is free.

Most ice climbing trips require an arduous trek into the mountains, possibly several nights out in the cold. Here, I was able to have lunch at a cafe (The Artisan Bakery) after my first n

EASY DOES IT

Crampons (right) help ice climbers get a grip





COOL CUSTOMER

The real reward, says Holmes, comes from overcoming fear

of climbing, and then return to the to work off my roast beef sandwich steep vertical pillar. At night, I slept the comfy confines of the Simba Suites and soaked my aching muscles in the steaming waters of the Ouray Hot Springs pool.

Ice climbing and rock climbing share many important features. Both use ropes, carabiners, and other specialized equipment for ascending steep rock or blue ice. But the actual climbing is different. A rock climber follows natural cracks or weaknesses in the rock and is limited to a narrowly defined climbing path. With crampons strapped to their feet and ice tools in each hand, an ice climber has more freedom to blaze their own path up and is limited only by the conditions and the technology of ice climbing rather than the natural features of the rock.

Don't try this without some expert instruction. San Juan Mountain Guides in Ouray offers all kinds of ice climbing outings that include equipment rental.

Group rates run from \$315 for four people to take a two-day basic course to \$995 for a five-day expert course. A one-day one-on-one lesson costs \$305. Skyward Mountaineering and Suntoucher Mountain Guides also offer Ouray outings.

GETTING THE ZIGZAG

ON MY FIRST DAY at the ice park, Clint Cook, chief guide for San Juan Mountain Guides, had me practice with one ice tool, starting at the canyon floor. He wanted me to find my balance between my feet and a tool stuck in the ice above my head. It's all about getting your weight on your feet and letting your arms rest. Cook describes the move as a zigzag, placing one tool above your head and then moving the triangle to the next staggered tool placement. "You can really go where you want on the ice and get into a groove and find a rhythm," Cook said. "For me, ice climbing is all about the rhythmic nature.

It becomes a vertical dance. I compare it to the waltz."

Marc Sargis, a 53-year-old real estate attorney from Chicago and avid ice climber, agrees. "It is a very elegant and beautiful motion," says Sargis, who picked up the rhythm of the ice about 15 years ago. "I love the feel of it." Sargis owns a second home in Ouray and climbs about 25 days each winter.

By the second day, I was getting the hang of it. Haaland, my guide for that day, suggested I was ready to lead our way up the frozen wall. There is a big difference between leading and following on a climb. When you follow, a rope will catch you immediately. When you lead, the rope is below you, and if you slip, you will fall 15 or 20 feet.

The real reward comes from overcoming fear. I climbed farther from my last ice screw, knowing that my fate now depended on a cool head and a solid technique. My initial fear gave way to a jolt of confidence as I heard the "thunk" of my tools embedding in the ice, of knowing that every kick of my crampons was sticking. In my mind, I was dancing on the ice, playing in my own frozen vertical gymnasium. ■■



TRAILBLAZER Holmes (left, in blue) preparing with instructor Clint Cook; above, successfully scaling a canyon wall in Ouray



Five Cures for Terminal Boredom

A long layover is most travelers' worst nightmare. Here are some airports that could—almost—serve as destinations. **BY GREG LINDS**

FRANKFURT PROFLIGHT FLIGHT SIMULATOR

The life-size simulators at Frankfurt (and at Berlin and Bremen) are identical to those used by Lufthansa pilots. For a steep fee of 325 euros, or \$429, for a three-hour session, a ProFlight instructor will brief you on aerodynamic principles and the cockpit's controls before firing up the simulator. (The same session on the Boeing 737 or Airbus A320 simulator costs \$363.) The virtual reality on these machines is flawless: The hydraulics can simulate bumps on the taxiway or severe turbulence. Taxi, take off, fly for a while, and land—then collect your souvenir pilot wings and run to catch your real flight.



SINGAPORE **CHANGI** **INTERNATIONAL** THE POOL AT TERMINAL 1

Buy yourself a swimsuit in duty-free if you haven't packed one and slip into the open-air rooftop pool just above the gates and tarmac. Nine dollars gets you the use of a locker, a towel, and a poolside

chaise, where the bartender will deliver Singapore slings. The only sounds are the peaceful lapping of the water and the whine of jet engines idling below.

ABU DHABI **INTERNATIONAL** AL GHAZAL GOLF CLUB

In a way, the entire 18-hole course is a sand trap. There are "browns" instead of greens, made of compacted sand, and the real hazards are burrows dug by dhubs, or desert lizards. The clubhouse could have been airlifted from St. Andrews. A round costs \$33 on weekends, \$28 during the week.

SAN FRANCISCO **INTERNATIONAL** THE AVIATION LIBRARY & LOUIS A. TURPEN AVIATION MUSEUM

Tucked inside the new international terminal on the near side of the security gates, the free museum is showing an exhibit of Pan Am memorabilia, while upstairs the rare-book library featuring vintage aviation manuals is one of the largest of its kind. The room itself is the real draw—it's a 90% scale model of the airport's original Spanish Mission-style

passenger terminal, built in 1937. Today airport terminals display fine pieces of art. Rupert Garcia Bird Technology, made of hand-painted ceramic tile, can be seen in Boarding G (below).

NEW YORK J **INTERNATIONAL** THE AIRPORT CHAPEL OF TERMINAL 4

In case you need a Mass or a marriage ceremony before your flight, JFK has been home to Catholic, Protestant, and Jewish chapels for more than 40 years. Our Lady of the Skies and Chapel for the World Church host regular services for a smattering of travelers and locals. The International Synagogue is a popular haven for passengers. Muslim travelers often stop to pray in a multi-denominational space a few doors away.





BY ROBERT PARKER

A Vintage Worth Investigating

ALL THE BORDEAUX VINTAGES since the exceptional millennium year, 2001 offers the best bargains today. That's especially true of the 2001 St.-Emilions, made from two grapes, merlot and cabernet franc, that ripened better than cabernet sauvignon that year. The most prestigious St.-Emilions are never cheap, but the following wines represent the best values given their high quality. Many of them are close to their 2000 counterparts yet sell for a fraction of the price and can be enjoyed much sooner.

Côtes

92 points. This medium-bodied wine possesses a ruby/purple color as well as superb aromas of chocolate, blackberries, licorice, and licorice. It displays striking purity and a broad range of flavor and texture. As it sits in the bottle, additional notes of chocolate and licorice become apparent. You can drink this beauty or enjoy it anytime over the next decade. \$28

Grandes Murailles

92 points. This small estate, under the same Reiffers family ownership as Clos St.-Martin and Côte de St.-Emilion, has produced great wines over a number of vintages, particularly 1998 and 2001. Its fabulous 2001 is a dense purple with glorious scents of blueberries, blackberries, crushed stones, and toasty oak. Medium- to full-bodied, it will be at its peak from 2007 to 2017. \$45

Confession

92 points. An impressive debut vintage from 40% merlot, 40% cabernet franc, and 20% cabernet sauvignon, it has a deep purple color and aromas of chocolate, licorice, blackberry and cherry liqueur,



and new oak. This full-bodied, surprisingly powerful 2001 is somewhat atypical of the vintage but is gorgeously textured and admirably pure. There is plenty of tannin in the finish, so two to three years of cellaring is suggested. \$55

Troplong Mondot

93 points. Not far off the pace of the spectacular 2000, the 2001 exudes a gorgeous perfume of plum jam, crème de cassis, flowers, licorice, black fruits, a hint of graphite, and well-integrated wood notes. This medium- to full-bodied St.-Emilion has superb texture, great flavor purity, and tremendous harmony. Remarkably approachable despite its impressive

concentration and well-concealed tannin, this beauty is a candidate for "wine of the vintage."

Anticipated maturity: now through 2017. \$60

L'Hermitage

92 points. One of the finest products I have tasted from this winery, the ruby/purple 2001 merlot/cabernet franc blend offers up aromas of black truffles, black currants, licorice, and toasty oak. Its full-bodied, chewy personality reveals abundant fruit and extract.

Heady and opulent, with low acidity, it should be consumed over the next 8 to 10 years. \$65

Monbousquet

91 points. The 2001, a blend of 60% merlot, 30% cabernet franc, and 10% cabernet sauvignon, is a flamboyant offering with a dense ruby/purple color as well as a big, sweet nose of licorice, dried herbs, smoke, black currants, and blackberries. Beautifully textured and medium- to full-bodied, this is a succulent, seductive claret to drink over the next 10 to 12 years. \$65

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

Rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras.

529s Just Might Make the Grade

The college savings plans have become more attractive—but do your homework. **BY ANNE TERGESEN**

GIVE PARENTS (AND GRANDPARENTS) a program that allows them to invest money tax-free for their kids' (and grandkids') education, and you would think it would be a smashing success. Yet eight years after the so-called 529 college savings plans launched, there's just \$82 billion in them. That may sound like a lot, but consider this: It's half the size of the Growth Fund of America, the nation's largest mutual fund.

But changes are under way that make the plans more attractive. For starters, last summer Congress made permanent the tax-free treatment of the plans' profits as long as the money is used for college. (The perk was previously scheduled to expire in 2010.) Some large investment companies that manage the state-sponsored plans are cutting their fees, too.

Improvements in the plans' disclosures make it easier to shop for a good deal. "Now is a great time to invest," says Andrea Feirstein, founder of AKF Consulting, which specializes in 529 plans.

The investor-friendly changes have come about for a few reasons. In 2004, Congress held hearings on 529 fees that highlighted the varied and often confusing ways in which plans disclosed them. Now, virtually every 529 program publishes standardized fee tables that do the math for you, presenting total fees for each investment option, says Feirstein.

At the same time, competition among financial services firms to run these plans on behalf of the states has intensified, fueling a price war of sorts. In recent months more than 20 plans managed by such major players as American Century, T. Rowe Price, Vanguard, and Wells Fargo have reduced or announced reductions in the fees they charge account holders—some by nearly 50%. Fidelity recently introduced index-fund investment options, at a cost of 0.50% each, in the plans it manages for

Arizona, Delaware, Massachusetts, and New Hampshire, matching the bargain rates it's offering in California. "The big 529 providers are really getting aggressive in structuring low-cost programs," says Joe Hurley, founder of savingforcollege.com, a site which helps investors compare plans. The cost-cutting is important because high fees can substantially erode—and in some cases, even erase—the plans' tax-saving benefits.



ne tax breaks can en-
ce investment returns,
cially over time horizons
0 or more years, says
Beardsley, director of
investment tax division
Rowe Price. For start-
earnings on the accounts
y free of federal and
income taxes, and once
withdraw them they're
free if used for college
ome qualified form of
er education. In addi-
residents of 27 states
the District of Columbia
educt on their state tax
ns at least a portion of
they contribute to their
e state's plans. Pennsyl-
a, Kansas, and Maine
ide up-front state tax
ctions for contributions
y 529.

ow much are these tax
fits worth? The answer
nds largely on your tax
et, as well as the invest-
mix in your account
your rate of return. If
e in the 25% federal tax
et and invest for a new-
in an all-stock portfolio
earns 7% a year, the
al tax exemption will enhance re-
by about 0.9% a year over 18 years,
ared with saving without the tax
ption, Hurley calculates. If you live
igh-tax state such as California, the
eak is worth an additional 0.30% or
at adds up to a total performance
tage of 1.20% a year for the college
gs plan. (The value of the benefit
or those in higher tax brackets and
portfolios that contain bonds, which
otherwise be taxed at a higher rate
stocks.)

ifornia doesn't offer a state tax de-
n or credit for putting money in a
r. But those breaks, where available,
the 529 even more attractive. For
imate of how much your state's tax
tion will boost your annual returns,
the calculator at archimedes.
ranktemp/stdc_529.phtml.

Of course, these benefits won't
a much if you make poor
ement choices or allow high
s to siphon off a big chunk of
k savings. Make sure the in-
tent you have in mind has a
id track record, compared with
benchmark. Then calculate the
ence between what you'll pay

The Lowdown on Low-Cost Plans

These 529 plans charge 0.6% or less in annual fees on their cheapest options that invest in equities. You can find links to their Web sites at savingforcollege.com.

STATE	SAVINGS PLAN	LOWEST FEE*
OHIO	CollegeAdvantage	0.25%
OREGON	Oregon College Savings Plan**	0.26
UTAH	Utah Educational Savings Plan**	0.28
VIRGINIA	Virginia Education Savings Trust***	0.33
WISCONSIN	EdVest**	0.35
ALASKA	Univ. Alaska College Savings Plan	0.38
ARIZONA	Fidelity Arizona College Savings Plan	0.50
CALIFORNIA	ScholarShare College Savings Plan	0.50
DELAWARE	Delaware College Invest. Plan	0.50
MASSACHUSETTS	U. Fund College Investing Plan	0.50
NEVADA	Vanguard 529 Savings Plan**	0.50
NEW HAMPSHIRE	UNIQUE College Investing Plan	0.50
KANSAS	Learning Quest**	0.51
NEW YORK	New York's 529 College Savings Program	0.55
MICHIGAN	Michigan Ed. Savings Program	0.60

*For plans that include equities; lowest-cost option. **Charge annual account maintenance fees ranging from \$20 to \$27, which may be waived under certain conditions. ***\$25 one-time enrollment fee
Data: Savingforcollege.com

for this investment in a 529, vs. a regular, taxable mutual fund.

Suppose you're a California resident. If you want to save for college using a Standard & Poor's 500-stock index fund, the cost for that in the California plan is 0.50%. That's five times the 0.10% cost of investing in Fidelity's Spartan 500 Index fund. Still, the 529 is well worth the extra 0.40%. Why? The tax benefits amount to 1.20% a year, so you still come out ahead.

As a general rule, if your home state offers a generous tax deduction, give it serious consideration, says Hurley. Otherwise, shop around. You may just find a better deal in another state's plan (table). If you're already in a plan, you can switch your child's account once a year,

free of taxes and penalties.

To ascertain the cost of a specific investment, dig into plan disclosure documents. (Savingforcollege.com publishes links to plan Web sites, where you can download these documents.)

That's not as hard as it sounds. To get the bottom line on California's ScholarShare College Savings Plan, for example, simply flip to the fee tables in the disclosure documents (table, below). Like a growing number of plans, California's offers both actively managed funds and cheaper index funds. All you have to do is glance at the second-to-last column, titled "Total Annual Asset-Based Fees." In the case of the index funds, you'll see that each charges 0.50%.

SHOP AROUND

IF YOU WANT to see what goes into that fee, start with the first column, "Estimated Underlying Fund Expenses." This tells you the annual cost of investing in each mutual

fund. In the case of the Spartan 500 Index fund, for example, the tab is 0.10%. The next column, "Program Manager Fee," tells you how much Fidelity receives for administration. It pockets 0.30% on the Spartan 500 Index fund. The "State Fees," of 0.10%, go to California to cover its expenses. California imposes no annual account maintenance fee. But if it did, it would be listed in the last column, and you'd want to add it in as well.

Sure, it takes a little time to shop for a plan. But when you're trying to amass enough to pay your newborn's tuition in 2025, those tenths of a percentage point can really add up. ■

SCHOLARSHARE PLAN FEE AND EXPENSE STRUCTURE (AS OF 11/16/06): INDEX FUNDS

Portfolio	Estimated Underlying Fund Expenses ¹	Program Manager Fee ²	State Fee ³	Miscellaneous Fee ⁴	Total Annual Asset-Based Fees ⁵	Annual Account Maintenance Fee ⁶
International Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A
Spartan 500 Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A
Total Market Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A



Dear IRS, Please Help

A “private letter ruling” by the agency can provide a way out of tax goofs.

BY LYNN O'SHAUGHNESSY

WHEN Faye Lange, an Emmy Award-winning actress, died during the Christmas holidays in 1992, she left behind a New York apartment and a portfolio of bonds and cash. But much of her net worth was tied up in an individual retirement account.

The star of the late 1960s television series *The Ghost and Mrs. Muir* intended for her two children to receive her share of the IRA, but she could never have imagined how an accountant and a lawyer, hired to help her plan, should have known better, had they followed her plans. Thanks to lousy advice, I had designated her estate as the beneficiary of her IRA instead of directly

er son and daughter. This might seem like a minor technicality, but it's a serious matter to the Internal Revenue Service. Leaving the IRA to the estate meant the account had to be closed within five years and proceeds distributed, which would have left the children with a monster tax bill. "It was disastrous," recalls Christopher Lange, who is trying to get a star on Wood Boulevard for his late mother. "I hired so-called experts who drew up the documents and oversaw the distributions to make sure they did it correctly."

ACTIVITY COUNTS

MURRAY AND HIS sister Patricia could have dodged the tax cudgel if they had been the only beneficiaries named in the trust. But other heirs, including Lange's father, Seymour, and The Actors' Fund of America, had their bequests parked in the same trust. Ultimately, Lange's accountant, who admitted she had never before had a client who died, suggested that the children might unravel the mess. She recommended that they hire the IRS for a so-called private letter ruling (PLR), which involves a process that is like a mini court case. To Murray's surprise, a favorable ruling arrived in the month of December that allowed the IRA to be distributed to him as though he were the original beneficiary. (His sister did not get the ruling, so she did not get the same treatment.)

A PLR can be a godsend to desperate taxpayers who are searching for a creative way out of a tax jam. "Private letter rulings can save fortunes," says Seymour Berg, senior partner at Goldberg & Berg in Jericho, N.Y., who has filed more than 100 PLR requests. "Millions of dollars can be involved."

The process typically starts when a taxpayer or accountant submits written questions to the IRS that detail why a taxpayer should receive a favorable ruling. What could be a murky tax question becomes the overwhelming majority of the questions sought by individuals—corporations seek them as well—involving estate trust matters, as well as retirement accounts. Getting a response from the IRS can take anywhere from a few weeks to a year and a half.

In recent years, the IRS has weighed in on some unusual requests. For instance, how persuaded the tax collectors were when a late husband open up an IRA. What was the reason she asked? Her husband had died with a big chunk of money in his estate plan, but since she had no other retirement plan, she would have been slapped

with a 10% early withdrawal penalty if she had rolled the money into a spousal IRA and tapped into it. She avoided the penalty when the IRS gave its approval to the posthumous IRA.

In another case, a man turned to the IRS after learning that his bank, through an account mix-up, had dispatched \$200,000 from his IRA to another customer. It took the guy four



years to discover the money was missing because he had blamed the cash drain on the dot-com market implosion. The bank agreed to pay for the tax request to ward off a costly lawsuit. Plenty of PLRs are sought by financial institutions and investment advisers who have made bone-headed, potentially irrevocable mistakes that could cost their clients dearly.

A PLR also helped John Striano's family after his father, who deteriorated rapidly after receiving a cancer diagnosis, didn't have the time or the strength to move his pension from his S corporation into an IRA that his children could preserve. The sports consultant had begun the process, but chemotherapy sapped any energy he had to deal with paperwork. "The idea of losing out on this money because my dad couldn't roll it over in time was flat-out rude," says Striano, an accountant at Deloitte & Touche in Orlando. The IRS permitted Striano and his sister to move the money into special annuities that will allow the twentysomething siblings to make minimum withdrawals from their tax-sheltered inheritance for decades.

By far the most common plea the IRS hears comes from taxpayers who botch the 60-day IRA rollover rule. Someone transferring money from a retirement plan, such as a 401(k) or another IRA,

has 60 days to make sure the cash gets tucked into another retirement account. Tardy taxpayers, however, must dismantle their IRAs and cough up the cash for the taxes, as well as a possible 10% early-withdrawal penalty. Congress, with its ambitious tax legislation in 2001, allowed some exceptions for rollover procrastinators, which has triggered a spate of "Mother-may-I" requests to the IRS.

Since then, more than 300 individuals have won rollover reprieves. "I look at the 60-day rulings like the Nielsen ratings for TV," says Ed Slott, a CPA in Rockville Centre, N.Y., and an IRA expert. "Everybody who goes for a ruling probably represents 1,000 others who could have sought one but didn't know about it."

A common thread runs through successful 60-day rollover rulings. "If you didn't use the money and you can show that you intended to do the rollover all along, and the reason you didn't was because of an error on the part of a financial institution or some physical limitation such as you were hospitalized, then you should get the ruling," says Barry Picker, a CPA in Brooklyn, N.Y., who handled Murray's PLR request.

One taxpayer who won a PLR was an alcoholic who tapped his IRA right before he was involuntarily hospitalized. By the time he emerged from his confinement, the 60-day clock had stopped. The IRS allowed him to roll it over anyway because he was incapacitated during the time he should have done it.

NO GUARANTEES

IF YOUR TAX SNAFU isn't a significant one, seeking a PLR may not be worth the cost. The IRS charges \$9,000 for most PLRs, while the least expensive rulings, involving 60-day rollover mistakes, max out at \$3,000 for six-figure IRAs. Of course, you also have to pay an accountant or attorney to research and file your claim.

Not everybody who has been squeezed by a tax tourniquet ultimately experiences relief from a PLR. Just ask the fellow who pulled his money out of his IRA to protect it from a possible tax levy while he was battling the IRS over a tax dispute. Once the conflict ended, the taxpayer wanted to return the money to the IRA long after his 60-day window had closed. In the PLR, he even admitted that he had yanked the cash to hide it. So what happened to his case? The IRS was definitely not impressed with his candor and turned him down. ■

HOPE LANGE A private letter ruling regarding her estate allowed her son to avoid a monster tax bill



BY GENE G. MARCIAL

WHY VOICES CRYING FOR A SALE OF **MEDIMMUNE** MAY GET LOUD

FEDERAL REALTY INVESTMENT TRUST IS ON A FIRM FOUNDATION

INVESTORS ARE FEELING A STRONGER PULSE AT **ANGIODYNAMICS**

A Buyer for MedImmune?

THE CROWD PRODDING MedImmune (MEDI) to put itself on the block is apt to get bigger—even though the seventh-largest U.S. biotech has rejected such a move. David Katz, president of Matrix Asset Advisors, which owns 1.8 million shares, has urged the board to sell to a strategic buyer, noting that MedImmune has “world-class products and intellectual property” whose value can best be marketed by a biggie such as Pfizer, Merck, GlaxoSmithKline, or Johnson & Johnson. Its products include FluMist, a nasal spray vaccine, and Synagis, an injectable antibody to treat respiratory infections in infants. “A number of the bigger stockholders agree with us,” says Katz, who figures MedImmune, now trading at 33, is worth 45. Among analysts who share Katz’s view is Geoffrey Porges of Sanford C. Bernstein, who says management and the board should “actively consider the sale of the company to a major pharmaceutical buyer that has the capital, expertise, and infrastructure to more effectively manage and commercialize the product portfolio.” Based on its earnings potential, MedImmune’s worth is in the mid-to-high 40s, says Porges. He sees earnings of 26¢ a share in 2006 and 88¢ in 2007, vs. a loss in 2005.



Raising the Roof At Federal Realty

ALTHOUGH FEDERAL Realty Investment Trust (FRT) beat third-quarter forecasts in November, the Street reined in its enthusiasm for the stock, then trading at 76, because of worries over the housing slump. The stock has since climbed to 84.34. FRT develops, manages, and owns high-quality condos and shopping centers on the East and West Coasts. When FRT was featured in this column on Dec. 5, 2005, it was at 65. Steve Sakwa of Merrill Lynch, which has done banking for FRT, recently upgraded his rating from “neutral” to “buy” after a review of FRT’s seven potential redevelopment projects. In a report, he figured FRT could generate \$367 million, or \$6.74 a share, of additional value in 5 to 10 years as properties are redeveloped. He sees FRT earning \$3.26 a share in 2006, \$3.62 in 2007, and \$3.87 in 2008. Jeffrey Donnelly of Wachovia Capital Markets (it has

done business with FRT) maintains his “outperform” opinion on FRT. Recent buyouts in real estate, he notes, have “cast a brighter light on the disparity between public and private market valuation for assets.” FRT’s shopping centers are in densely populated markets with high household incomes. Better yet, occupancy rates are high at its holdings, and rents are rising.



AngioDynamics: Growth Is in Its Veins

FOR A LITTLE-KNOWN medical-device maker, AngioDynamics (ANGO) is a dynamo. A leader in equipment for minimally invasive diagnosis and treatment of vascular diseases, it is expanding into the interventional oncology market, specifically the use of image-guided thermal probes to destroy tumors (“ablation”), which could possibly double sales by next year. “In that sense, AngioDynamics is a pretty aggressive growth stock,” says Jeff Jonas of GAMCO Medical Opportunity Fund, which owns 362,000 shares. Based on such momentum, he thinks the stock is undervalued. In November, AngioDynamics acquired RITA Medical, No. 1 in the \$2 billion tumor ablation market and No. 2 in implanted medical devices for drug therapies. RITA’s products will add some \$52 million in sales to AngioDynamics’ \$101 million in its fiscal year ending May 30, 2007. In 2008, CEO Eamonn Hobbs expects sales to rise sharply because of the acquisition of RITA and Oncobionics, which owns a novel technology for tumor ablation. Phil Nalbhone of RBC Capital, which has done banking for AngioDynamics, forecasts earnings of a share in fiscal 2007 and 93¢ in 2008, vs. 53¢ in 2006. I rates the stock, now at 21.97, “outperform,” with a 12-month target of 30. ■



BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Calculus Is the Exploration of Two Basic Ideas. Master Them and Open a New World for Yourself!

Change and Motion: Calculus Made Clear on DVD

One of the greatest achievements of the mind is calculus. It belongs in the pantheon of our accomplishments with Shakespeare's plays, Beethoven's symphonies, and Einstein's theory of relativity. Calculus is a beautiful idea exposing the rational workings of the world.

Calculus, separately invented by Newton and Leibniz, is one of the most useful strategies for analyzing our world ever devised. Calculus has made it possible to build bridges that span miles, to travel to the moon, and predict patterns of population change.

Expanding the Insight

For all its computational power, calculus is the exploration of just two ideas—the derivative and the integral—of which arise from a common analysis of motion. All a 1,300-page calculus textbook holds, Professor Michael Starbird asserts, are those two ideas and 1,298 pages of examples, applications, and variations.

Professor Starbird teaches that calculus does not require a complicated vocabulary or notation to understand it. Calculus is a crowning intellectual achievement of humanity that all intelligent people can appreciate, enjoy, and understand."

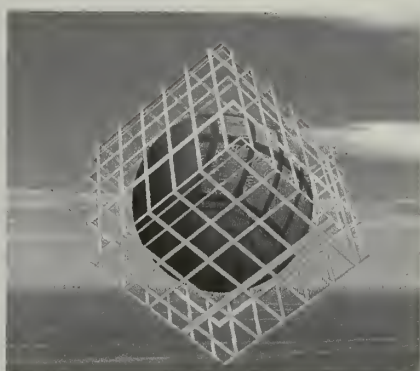
This series is not designed as a college calculus course; rather, it will help you explore calculus around you in the everyday world. Every step is in English rather than "mathese." The course takes the approach that every equation is also a sentence that can be understood, and explained, in English.

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Professor Michael Starbird is a distinguished and highly popular teacher with uncommon talent for making the wonders of mathematics clear to non-

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ing mathematicians. He is Professor of Mathematics and a Distinguished Teaching Professor at The University of Texas at Austin. Professor Starbird has won several teaching awards, most recently the 2007 Mathematical Association of America Deborah and Franklin Tepper Haimo National Award for Distinguished College or University Teaching of Mathematics, which is limited to three recipients annually from the 27,000 members of the MAA.

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6. Derivatives the Easy Way—Symbol Pushing
7. Abstracting the Derivative—Circles and Belts
8. Circles, Pyramids, Cones, and Spheres
9. Archimedes and the Tractrix
10. The Integral and the Fundamental Theorem
11. Abstracting the Integral—Pyramids and Dams
12. Buffon's Needle or π from Breadsticks
13. Achilles, Tortoises, Limits, and Continuity
14. Calculators and Approximations
15. The Best of All Possible Worlds—Optimization
16. Economics and Architecture
17. Galileo, Newton, and Baseball
18. Getting off the Line—Motion in Space
19. Mountain Slopes and Tangent Planes
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Stocks fell during the short week. Financial markets were closed on Jan. 2 in observance of a national day of mourning for former President Gerald R. Ford. Equities cooled on Jan. 3 as notes from the Federal Reserve's Dec. 12 monetary policy meeting showed no hint of an imminent interest rate cut. Falling commodity prices hit mining and energy issues.

Data: Bloomberg Financial Markets, Reuters

4-WEEK TOTAL RETURN
WEEK ENDED JAN. 2

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY

Fund	4-Week Total Return (%)
S&P 500	0.4
U.S. DIVERSIFIED	-0.8
ALL EQUITY	-0.2

52-WEEK TOTAL RETURN
WEEK ENDED JAN. 2

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY

Index	Return (%)
S&P 500	14
U.S. DIVERSIFIED	11
ALL EQUITY	12

Data: Standard & Poor's

S&P 500	1416.6	-0.7	-0.1	11.6
Dow Jones Industrials	12,474.5	-0.3	0.1	15.0
NASDAQ Composite	2423.2	-0.3	0.3	8.0
S&P MidCap 400	807.2	-0.8	0.4	7.8
S&P SmallCap 600	399.2	-1.4	-0.2	12.1
DJ Wilshire 5000	14,202.2	-0.7	-0.1	11.8

BusinessWeek 50*	793.6	-1.0	-0.6	4.3
BW Info Tech 100**	453.8	1.4	1.4	16.4
S&P/Citigroup Growth	651.2	-0.7	-0.2	7.3
S&P/Citigroup Value	763.9	-0.7	0.0	16.1
S&P Energy	438.8	-4.4	-3.7	12.6
S&P Financials	496.6	-0.6	0.3	14.6
S&P REIT	198.9	0.6	0.0	27.2
S&P Transportation	264.3	0.0	0.2	6.1
S&P Utilities	187.4	-0.1	0.4	15.1
GSTI Internet	200.5	-0.9	0.4	-3.2
PSE Technology	875.8	-0.4	0.0	3.2

*March 19, 1999=1000 **February 7, 2000=1000

Tires & Rubber	35.7	Steel	68.3
Drug Chains	11.9	Intgrd. Telecomms. Svcs.	42.2
Forest Products	11.9	Broadcasting	41.7
Paper Packaging	10.6	Investmt. Bnkg. & Brkrge.	38.4
Health-Care Supplies	10.1	Motorcycles	36.8

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Pacific/Asia ex-Japan	4.2	Pacific/Asia ex-Japan	38.4
Latin America	3.2	Latin America	38.4
Diversified Emerging Markets	2.2	Real Estate	29.8
Foreign	1.9	Europe	29.3
LAGGARDS		LAGGARDS	
Natural Resources	-3.6	Japan	-4.0
Precious Metals	-2.8	Health	3.4
Mid-cap Growth	-1.9	Large-cap Growth	5.3
Technology	-1.7	Technology	5.7

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Baird Mid Cap Instl	14.9	Dreyfus Prem. Grtr. China A	80.9
iShares FTSE Xha. Ch. 25 Idx.	14.8	Old Mut. Clay Finlay Ch. A	78.6
API Efficient Frnr Val. P	13.7	Oberweis China Opport.	78.4
Legg Mason Eq. Tr. Bal. Prim	12.6	iShares FTSE Xha. Ch. 25 Idx.	78.1
LAGGARDS		LAGGARDS	
Dunham Real Estate Stock C	-21.7	Ameritor Investment	-85.7
Gab. WldInd. Sm. Cap Val. A	-21.5	DireXn. Emrg. Mkts. Short	-46.4
Westwood Income A	-18.0	DireXn. Sm. Cap Bear 2.5X	-29.2
American Indep. Intl. Eq. A	-17.7	American Heritage Grth.	-25.0

	Index	Value	% Change
S&P Euro Plus (U.S. Dollar)	2012.3	1.5	1.1
London (FT-SE 100)	6319.0	1.2	1.6
Paris (CAC 40)	5610.9	1.3	1.2
Frankfurt (DAX)	6691.3	1.2	1.4
Tokyo (NIKKEI 225)	17,225.3	0.0	0.0
Hong Kong (Hang Seng)	20,413.4	3.5	2.2
Toronto (S&P/TSX Composite)	12,701.4	-1.2	-1.6
Mexico City (IPC)	26,619.4	1.6	0.6

S&P 500 Dividend Yield	1.79%	1.77%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.8
S&P 500 P/E Ratio (Next 12 mos.) *	15.4	15.3
First Call Earnings Surprise *	8.10%	6.10%

S&P 500 200-day average	1318.3	1316.4
Stocks above 200-day average	74.0%	73.0%
Options: Put/call ratio	0.82	0.80
Insiders: Vickers NYSE Sell/buy ratio	6.47	6.69

Coal	-18.9	Education Services
Oil & Gas Exploration	-12.3	Homebuilding
Oil & Gas Refining	-10.9	Internet Software
Oil & Gas Equipment	-10.5	Gold Mining
Computer Retailers	-9.9	Internet Retailers

KEY RATES	JAN. 3	WEEK AGO
Money Market Funds	4.87%	4.88%
90-Day Treasury Bills	5.05	4.97
2-Year Treasury Notes	4.76	4.77
10-Year Treasury Notes	4.66	4.66
30-Year Treasury Bonds	4.76	4.78
30-Year Fixed Mortgage †	6.04	6.00

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10YR. BOND	30YR.
General Obligations	3.80%	4.40%
Taxable Equivalent	5.43	5.90
Insured Revenue Bonds	3.93	4.40
Taxable Equivalent	5.61	6.00

INSTALLMENT CREDIT *Monday, Jan. 8, 3 p.m. EST* » In November, consumers probably accumulated \$3.1 billion of debt, after a \$1.2 billion drop in October. That's the median forecast of economists polled by Action Economics. The overall October decline was due to a drop in non-revolving credit, made up largely of auto loans.

INTERNATIONAL TRADE *Wednesday, Jan. 10, 8:30 a.m. EST* » The November

RETAIL SALES Friday, Jan. 12, 8:30 a.m. EST » Retail sales probably increased 0.6% on slightly stronger light-vehicle sales in December, after a solid 1% rise in November. Excluding vehicles, sales likely grew 0.5% after a 1.1% jump in November.

BUSINESS INVENTORIES Friday, Jan. 12, 10 a.m. EST » Inventory levels most likely edged up 0.2% in November, following a 0.4% rise in October.

The *BusinessWeek* production improved to 285.6 for the week ended Dec. 23, a 6.4% gain from year ago. Before calculation of four-week moving average, the index bounced up to 289.4.

BusinessWeek .co

For the BW50, more investment data, and the components of production index visit www.businessweek.com/extras

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Zeros, Ones, and Headaches

DREAMING IN CODE Two Dozen Programmers, Three Years, 4,732 Bugs, and One Quest for Transcendent Software
By Scott Rosenberg; Crown; 400pp; \$25.95

Do you ever wonder why it took Microsoft Corp. more than five years to deliver Windows Vista, the latest version of its PC operating system? Are you baffled that some software products lack the one feature that would make them so much simpler? Have you had it with programs crashing? These are some of

the mysteries of software, which is simultaneously an amazing boon for humankind and one of its scourges.

To better understand such matters, take a look at Scott Rosenberg's *Dreaming in Code: Two Dozen Programmers, Three Years, 4,732 Bugs, and One Quest for Transcendent Software*. The volume is a fascinating, yet ultimately frustrating, look inside one software-development project.

Rosenberg, co-founder of the online magazine Salon.com, knows his subject. He began tinkering with code in 1975 when, as a 15-year-old, he was given access to a New York University computer. Twenty-five years and many lines of code later, as managing editor of Salon.com, he experienced the frustrations of publishing a magazine with Web software. His tussles with programs made him want to better understand the process of software development. He decided to track the course of a single software project and tell its story.

For his target, Rosenberg chose Chandler, a project organized by PC industry pioneer Mitch Kapor. Kapor founded Lotus Development Corp., which published the first killer app of the PC era, the Lotus 1-2-3 spreadsheet. A true free spirit, Kapor dropped out of Lotus when it became big and bureaucratic, tried his hand at venture capital, and then settled in as a champion of online civil liberties and open-source software. Chandler, named after Raymond Chandler, the detective-novel author, began as an effort to invent a better electronic calendar—one that was easy to use, easy to share, and available on a variety of computers. Such a goal might seem simple and straightforward. Not so here: Although formal work on the project began in 2002, there is no end in sight. The “preview” version of Chandler is expected to be launched in the spring of 2007.

Why has development taken so long? Several reasons: Along the way, Kapor and his compatriots at the Open Source Applications Foundation decided to expand the functions in Chandler to include e-mail, task, and project management as well as group collaboration. This, in the parlance of the

software industry, is called “feature creep” and is as common as it is irresistible. Second, technology changed, another common occurrence. Chandler started off as a program would run on your PC and connect with others via peer-to-peer networking technology. As the project evolved, its designers added a server program to aid in the sharing of data and an online version called Scooby. And finally, figuring out how to build a new program, and then building it right, just plain hard.

Rosenberg takes the reader inside the process to experience its joys and irritations. His scenes are vivid: conference rooms in San Francisco and Belmont, Calif.,

see celebrated software programmers of the PC era fill whiteboards with scribbles as they struggle over the large and small challenges involved in making something useful out of millions of zeros and ones. The cast of characters includes Andy Hertzfeld, a key member of the original Apple Macintosh development team; Lou Montulli, a Web browser pioneer; and John Anderson, who managed software development for Steven P. Jobs's NeXT Software Inc. While these scenes may lack high drama, there's plenty of tension. As the project drags on, the frustration of key programmers and managers quiets down. Meanwhile, some journalists and even

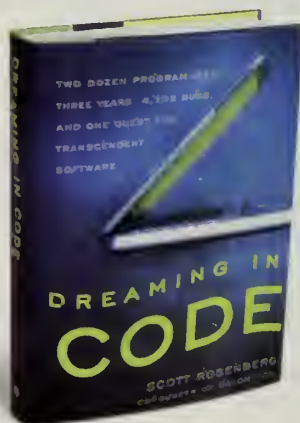
members of the open-source community write the project as a lost cause.

In a sense, Rosenberg bailed as well. Under dead-end pressure from his publisher, he sat down to write the book even though the project had not been completed. “My story's threads,” he says, “are beginning to vanish into a software time black hole.” Rosenberg says that he felt he had experienced enough to get a true picture of how software is made. But to the reader,

longs for resolution, that's not altogether satisfying.

Toward the end, the author waxes profound, comparing software creators to Sisyphus, the Greek hero condemned to endlessly roll a boulder up a mountain. However apt the analogy, Rosenberg does not believe software-making is an exercise in futility. There's pleasure in it, and eventually software gets shipped. Someday, presumably, a final version of Chandler will, too. ■

—By Steve H



Development hell, as evinced by a seemingly simple programming project

The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST
WHY WE WANT YOU TO BE RICH Donald J. Trump, Robert T. Kiyosaki, Meredith McIver, Sharon Lechter (Rich Press • \$24.95) <i>Help for the shrinking middle class.</i>	1	2		1 GOOD TO GREAT AND THE SOCIAL SECTORS Jim Collins (Collins • \$11.95) <i>A primer on how noncorporate organizations can excel.</i>	1	12	
THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • \$30) <i>Globalization is great—sort of, says a columnist for The New York Times.</i>	2	19		2 WHAT COLOR IS YOUR PARACHUTE? 2007 Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The enduring job-search bible.</i>	2	4	
FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • \$27.95) <i>Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.</i>	3	20		3 LEADERSHIP AND SELF-DECEPTION The Arbinger Institute (Berrett-Koehler • \$14.95) <i>A leader's motivation is what matters, says this business fable.</i>	3	8	
BLINK Malcolm Gladwell (Little, Brown • \$25.95) <i>Snap judgments deserve careful consideration.</i>	4	23		4 COLLAPSE Jared Diamond (Penguin • \$17) <i>From Easter Island to Central America, why civilizations fall apart.</i>	5	10	
JIM CRAMER'S REAL MONEY James J. Cramer (Simon & Schuster • \$26) <i>The "10 Commandments of Trading," from CNBC's wild man.</i>	8	20		5 THE INTELLIGENT INVESTOR, REVISED EDITION Benjamin Graham, with Jason Zweig (HarperBusiness • \$19.95) <i>The classic treatise on "value investing."</i>	6	19	
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13 BUILT TO LAST James C. Collins, Jerry I. Porras (HarperBusiness • \$17.95)

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and more are available on www.businessweek.com



Private Equity's Next Targets

PRIVATE EQUITY was the business story of 2006, and it's far from over. Deals for companies with market caps as high as \$60 billion—previously unheard of—are now being contemplated. And the rivalry with Wall Street doesn't stop with the race for investor dollars. The competition is getting more intense for executives who, like just-departed Home Depot CEO Bob Nardelli, are uncomfortable with the new corporate confines. The questions for '07: Will the Fed get stricter with lenders? Will a major deal collapse and cause regulators to tighten the screws? I caught up with David Rubenstein, co-founder of private-equity heavy-hitter Carlyle Group, to get his take on where this juggernaut is headed.

What are your expectations for 2007? Can this keep up?

It's hard to believe it can get any better. [But assuming that there is no] cataclysmic event like 9/11, or a government regulation that will collapse the industry...I think in 2007 you will see much more money going into emerging markets—China, India, and Southeast Asia, including Vietnam. We have more money in Asia than anyone, though [a recent] *New York Times* article barely mentioned us. And we will double it in a year. We are moving into the Middle East. Brazil and Latin America will see much more volume. Also Africa. In '07, I think the new thing will be commodities and natural resources. Not just companies but agricultural resources and mines. Another trend: You will see more hedge fund money coming into the private-equity space. We just saw that effort to buy Delphi [page 38]. Private equity will spend more time on...buying people. Now [Carlyle] is getting the Lou Gerstners of the world or the David Calhouns...enabling us to convince people that we can and will add value to businesses.

Will we see more regulation of private equity?

The Declaration of Independence says we are supposed to pursue happiness, but when people are too happy, the government doesn't like it. And right now, private equity is very happy. We have a new Congress, and while there isn't a particular problem people have put their finger on, I suspect you will see more attention to private equity. The fact is that in the last couple

of years, other than Refco, no major buyout has failed. If one deal doesn't work, you will have people coming out of the woodwork saying: "See, I told you so...these guys are not as responsible as people thought, and we should look closer." KKR, Texas Pacific Group, Carlyle, and Blackstone have just organized a trade group...to let people know what private equity is doing. We have done a terrible job of explaining how we make money, how we add value, and the fact that most of the money we make goes to pension funds and blue-collar workers.

Let's talk about Asia. What obstacles do you encounter?

We started to buy a company in China about three years ago, but it still hasn't been approved. The Chinese do not wake up every day and say: "How can I make the world richer...how can I help Carlyle Group?" Remember, for 15 of the last 17 centuries, China was the world's biggest economy. So in its mind, China is reclaiming its dominance. They don't need our capital as much as our knowledge, skills, and technology. They aren't interested in buying prized companies just to get more money. They don't need it. On the other hand, China is fertile territory. If you are on the ground floor today, in 15 years you won't be there.



RUBENSTEIN of Carlyle Group: Closer scrutiny from the new Congress?

Is it fair to say the good people are leaving Wall Street for private equity?

At the top level, people who have great success managing businesses are saying: "Why am I working in such a transparent business...a public company making \$1 million or \$2 million a year getting beaten up all the time? Why not run a private business?" The people doing midlevel jobs at investment banks are saying that while they won't get [Goldman Sachs CEO] Lloyd Blankfein's job... they

make a lot of money. But they are leaving to go to private equity because they can make more money. And business school graduates who in the old days were going to Procter & Gamble and McKinsey now see their friends making so much money that the best ones are going to private equity and hedge funds. There is a brain drain of people going to med school and law school. I always say I would hate to be operated on by someone in the next 10 years. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell



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IdeasTheWelchWay

BY JACK AND SUZY WELCH

Avoiding Strikes—and Unions

We're an American company that manufactures tools in Asia. Recently, workers at our largest Chinese facility went on strike demanding higher pay, even though we're definitely at the same level as factories around us. How can we avoid this problem in the future?

—Ray Lin, Long Beach, Calif.

For starters, you can ask yourself: “What caused this problem in the first place?” Or better yet: “Who caused it?” Because in our experience, whether it’s a compulsory union striking a Chinese factory, a Dutch works council threatening a walkout, or a card-signing campaign at a nonunion plant in Ohio, when local labor issues erupt, the trouble can usually be traced not to workplace conditions, but to workplace leadership. In fact, it can often be traced to one or two people: a horse’s “neck” of a plant boss or foreman who is being abusive, insensitive, bullying, secretive, or all of the above. In short, bad management most likely caused your strike.

Which is actually good news. Because, to answer your question, it means you can minimize the chances of a future strike by employing plant leaders who are transparent, candid, fair, and respectful. Of course, in China, as everywhere, plant leadership and factory workers won’t always agree. There will be honest differences over work rules and the like. But if you insist that your plant managers abide by two straightforward principles, you may find union activity fading away in time. The fact is, with good management, unions aren’t really necessary at all.

The first principle is really a mindset: an understanding by management that your workers are your people. They live in the same town, work for the same company. Their lives and futures are entwined with yours. You win or lose together. When plant managers have that mindset, it is much more natural for them to practice the second principle: Give workers a voice and dignity.

Now that may all sound like motherhood and apple pie, corporate pieties that are easy to scoff at, but they are maxims that matter. All employees, not just the ones carrying briefcases, need to be heard. Factory workers in particular need to know they are more to the company than just a pair of hands at a machine. Their ideas count.

Local plant managers with integrity and candor are the answer

How does a plant manager prove that? First by listening both at forums where workers are encouraged to discuss ways to improve operations, and informally, by walking floor. Nothing builds resentment like a factory boss standing cross-armed in his glassed-in office, overseeing from on high. Everyone below knows he is missing half of what he needs to know—and is still being paid handsomely.

Plant managers also give workers dignity by communicating with unrelenting candor and transparency. About what? Well, everything. Costs, the competitive situation, growth plans, economic bumps ahead. Most important, plant managers need to let workers know which issues are negotiable and which are untouchable. That information cannot be “revealed” during formal negotiations; such a bomb invariably leads to macho chump and war.

No, what you need are local plant leaders who are comfortable with dialogue. That builds trust, and ultimately it is trust that deactivates unions. When managers operate transparently and fairly and workers know it, there is no room for a third party to broker the conversation between them. There is just one team, working together to win.

There’s an old saying: “It’s not what you know, it’s who.” How true is that in terms of career success?

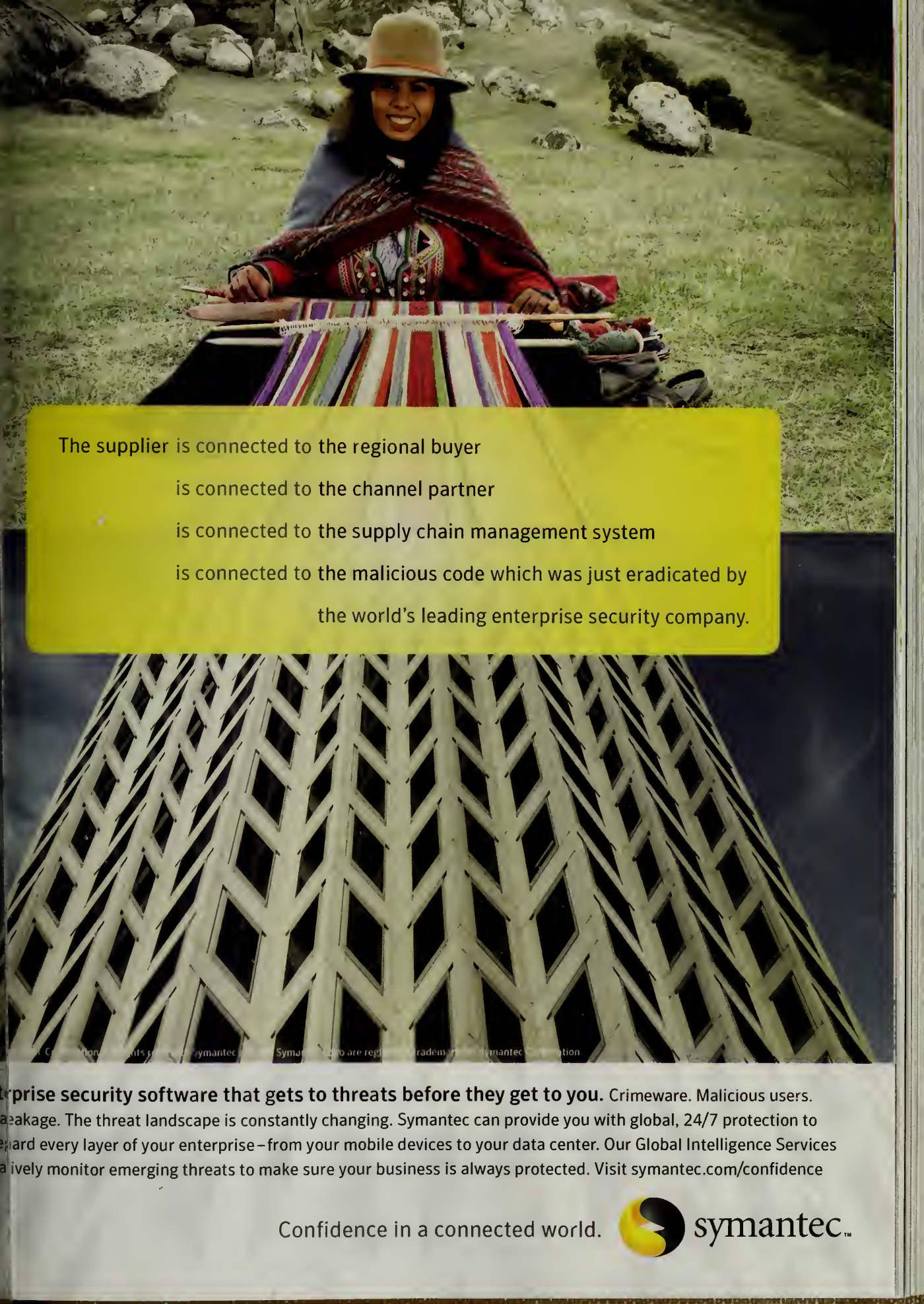
—Ling Chen, Jiangsu,

It doesn’t matter how true it is. You just cannot let yourself believe it.

Oh, sure, sometimes a person gets ahead because his father used to work with so-and-so or his college roommate was part of this or that family. Connections happen, and when they do, mediocre people can leap forward faster than they deserve. That’s discouraging. But the minute you start thinking connections are more important to advancement than brains, positive energy, and hard work, you are signing up for a bad attitude, or worse, our favorite nemesis: self-inflicted victimhood. You start thinking: “It doesn’t matter what I do. Some dope out there with a better pedigree has the edge.” Not only is that self-defeating, it’s just not true. The world is filled with people who started with nothing and brains and passion to create their own connections.

Put your head in that place and keep it there. The victimhood vortex takes you only one place: down! ■

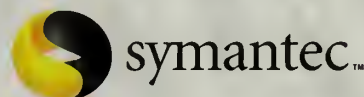
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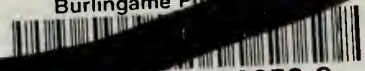
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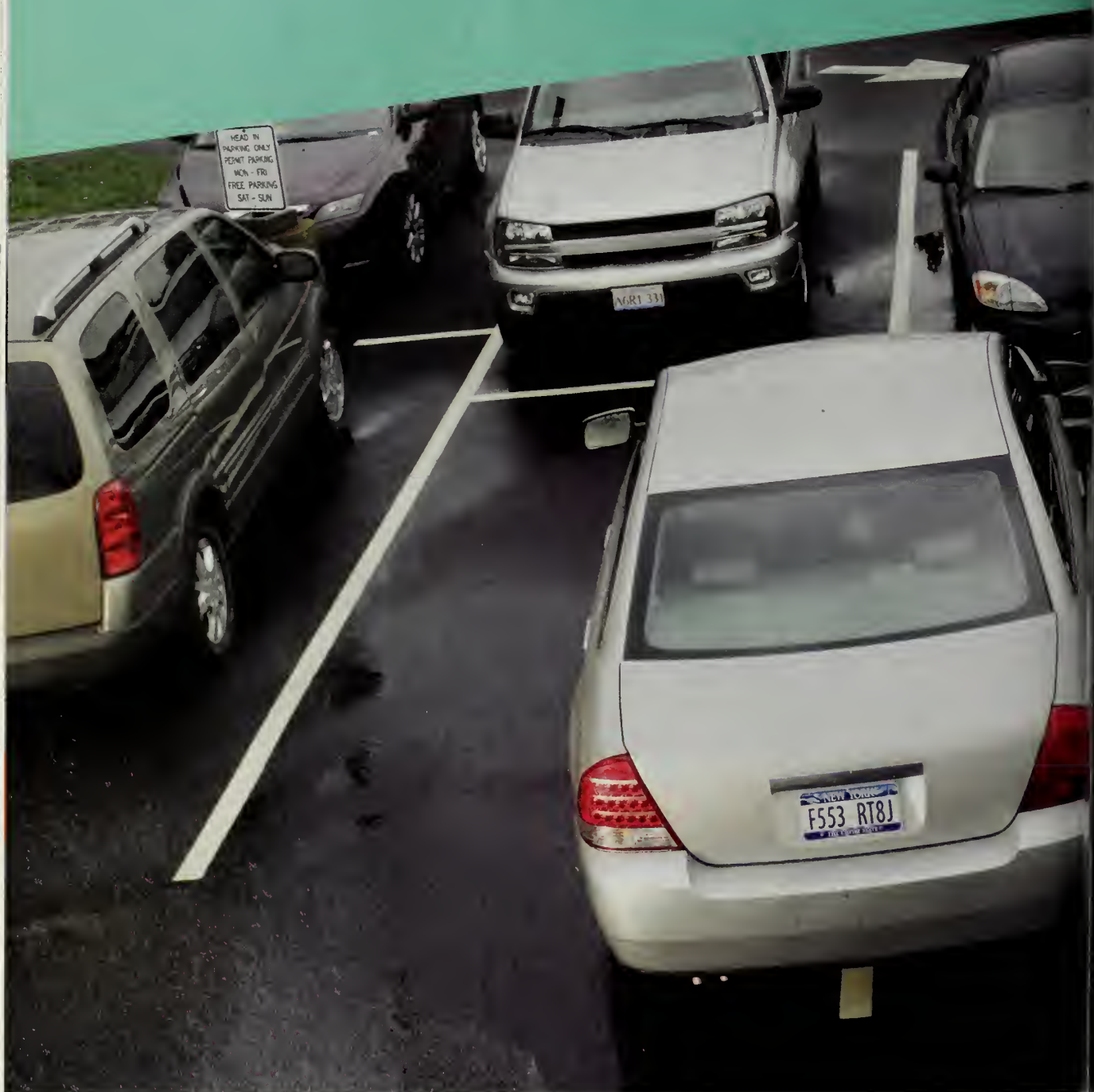
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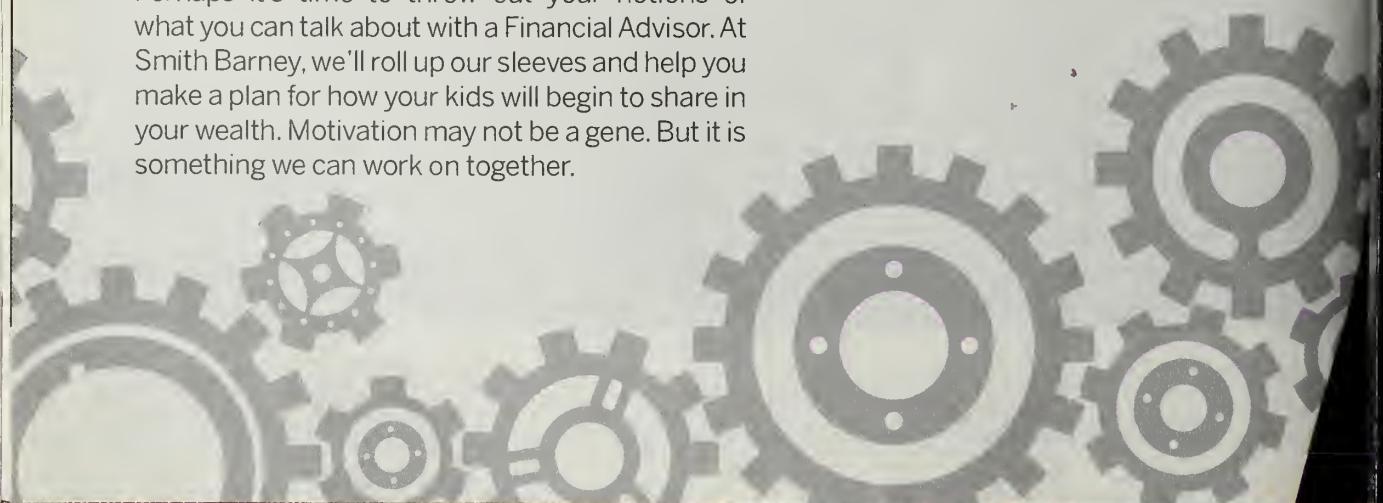
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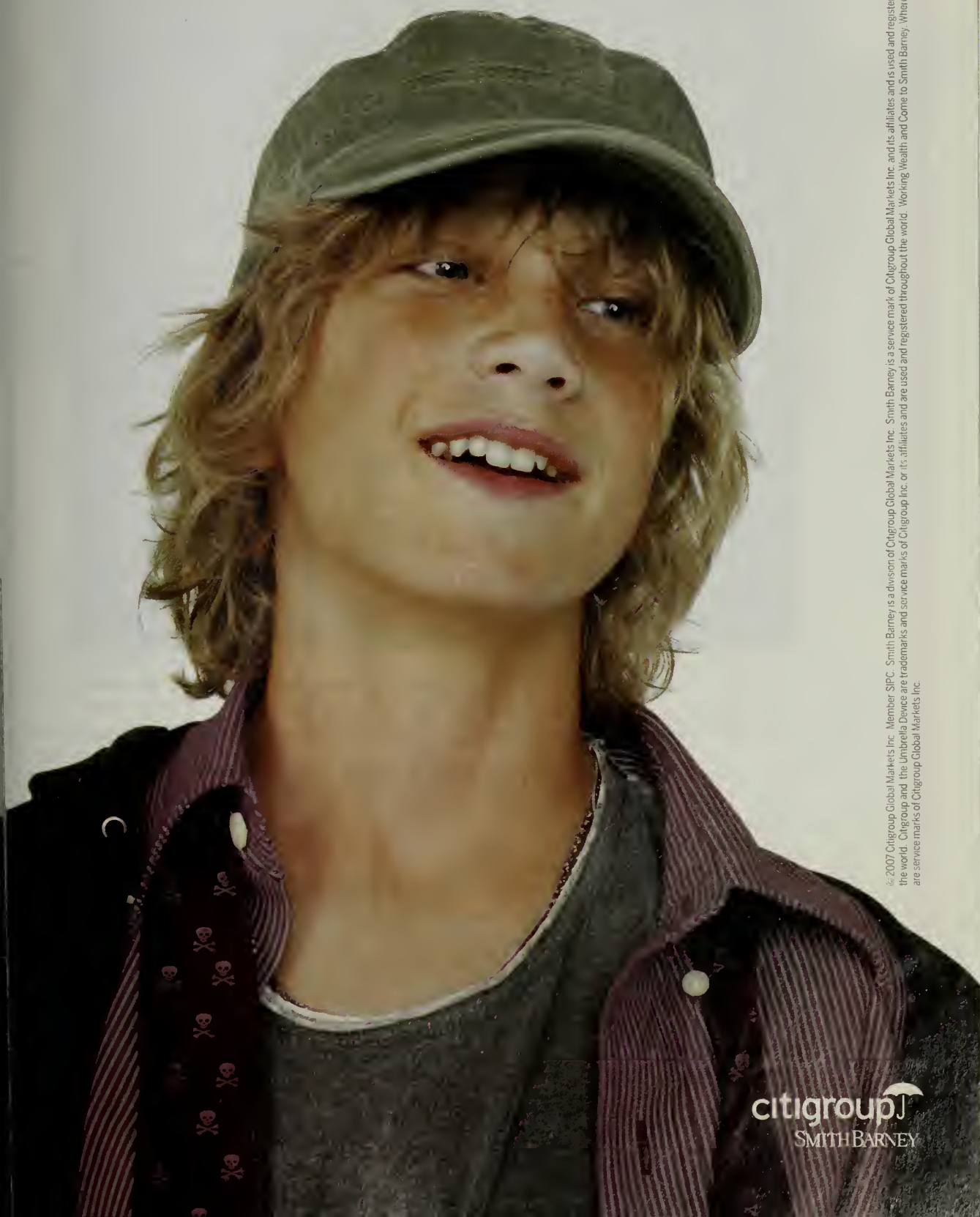
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Oil; the health governor; Gap grabs; patent wars; and more

News & Insights

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Mutual fund managers are singly asserting themselves

Apple's Very Smart Phone

Steve Jobs's latest gadget should throw the daylights out of phone makers

The Techie's Lexicon

They were talking about at the Consumer Electronics Show

Smoke and Mirrors for Home Buyers

Agents are pulling homes off the market and relisting them as "new"

School Dreams

It was Wall Street, then it was the market, now it's a job in private equity

Donald, All the Time

Nonstop media event called Trump

Global Business

China Feels the Heat

It was an *annus horribilis* for the country, and the problems aren't over. Will CEO John Browne leave early?

Even Toyota Isn't Perfect

The company's recalls have it scrambling to guard its reputation for quality

Outsourcing to the Outskirts

Services jobs are transforming rural lives in India

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Serving on a corporate board used to be a breeze. But activist shareholders, tougher rules, and mounting anger over supersized CEO pay have turned directorships into risky business. And as lawsuits fly, it's not just directors' positions on the line—it's their personal assets

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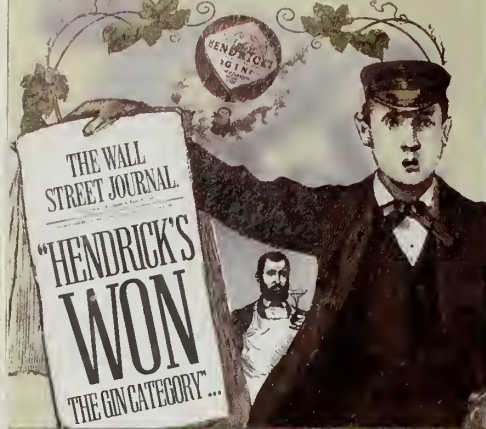
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FRIDAY, AUGUST 29, 2003 - VOL. CXXIII NO. 43 - \$1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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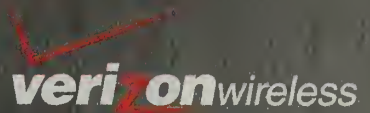
Anointing the iPhone

The much anticipated unveiling of Apple's new **music-playing iPhone** on Jan. 9 was greeted with fanfare by the Apple faithful and was welcomed by investors, who sent the company's share price soaring (page 40). But elsewhere in techdom they weren't cheering: BlackBerry parent Research In Motion and other makers of mobile devices became instant Apple rivals. In a *BusinessWeek.com* special report, **The Apple Economy**, we explain why the innovative iPhone is likely to rankle RIM and much the rest of the wireless industry. Our slide show makes clear what's so unique (for now, anyway) about the phone and **Apple TV**, a new device for moving content from PCs to TVs. We also look at how Apple's success is influencing the way companies in a variety of industries now work to design their own innovative products. And lest you think that Apple is emphasizing consumer electronics at the expense of its computer business, we explain why corporations that long shunned Macs for machines that run Microsoft Windows are giving Apple's products a second look. Go to www.businessweek.com/go/07/apple for all this and more.

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JP Front

"There's plenty of winter still left."

—Jeremy Batstone, head of research at Charles Stanley, on speculation that unseasonably warm weather in the U.S. Northeast has helped send oil prices tumbling, as reported by Reuters

BY DEBORAH STEAD

MEET NEWS BIG BOARD AL WITH LINTERS

THE NASD, which
ates **NASDAQ**, and
Regulation, its **New York**
Exchange counterpart,
nced a merger on Nov.

er years of fruitless

the deal
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through.

d, the
o create
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ght body
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alers—

to eliminate costly
lancies and to align
has hit a snag. As a
vote on the merger
a group of small NASD
ers is campaigning
o stop the union.

al Industry Assn. co-
r John Busacca is
g his small-brokerage
ers to vote against the
dation, saying that
v regulatory entity

would marginalize small
and midsize brokers by
eliminating the one-member,
one-vote rule that now
regulates elections to the
NASD board of governors.

The NASD is taking
Busacca & Co. seriously.
In a Jan. 8 e-mail it urged
members not to sign over
their proxies to Busacca, and
it has been buying banner
ads in Web publications

to promote
the benefits
of having
a single
oversight
body. It has
also enlisted
industry
leaders like

the **Financial Services Institute**,
a trade group of independent
broker-dealers, to rally
support for the merger.
Busacca, who holds several
hundred proxies in addition
to an unknown number of
nay votes already cast by his
allies, says the outcome is
too close to call. The NASD,
which is tracking the voting,
won't say who's ahead.

—Lorraine Woellert



BOOM AND BUST

About That Short Housing Slump...

HAS HOUSING hit bottom? Not if history is any guide, says Hugh Moore, a partner at **Guerite Advisors**, a money manager in Greenville, S.C. Using data from the seven previous housing cycles since 1959, Moore concludes that the sector will fall further—and land hard. Take housing starts. In the past, they fell an average 51% from peak to trough. So the current downturn, with housing starts off about 30% from the January, 2006, peak has further to go. And it may meet recession on the way. That's because in six of the seven cycles, when starts fell more than 25% from their most recent peaks, the economy tanked.

Another gloomy stat: In the same seven cycles, the amount people spent on new housing as a percent of gross domestic product fell an average 28% from market peak to trough. Worse, in six cycles, recession kicked in when the ratio fell more than 10% from its most recent peak. In this slump, Moore says, that ratio has fallen 10.5% from its fourth-quarter peak.

History also shows housing corrections take an average 27 months. Thus, the current doldrums may linger a year or more. "It's just going to be this slow, grinding drain on the economy," says Moore, who adds that month-to-month housing stats producing relief rallies are "just noise." —Mara Der Hovanesian

VERBATIM

Shareholder activist Carl Icahn,
interviewed in the January issue of
Avenue, a magazine covering New York's
social Establishment:

have my anti-Darwinian metaphor: The CEO is the fraternity
type who is great to have a drink with. He's a survivor and
not all that smart, but he works his way up the ladder in the
tion. And if you're a survivor you never have someone beneath
who's smarter than you. So you eventually work your way to CEO.
be someone a little dumber than you underneath, and eventually
ve morons running everything...which we're getting closer to."

ON BOARD



BILLY BEANE

NETSUITE BUILDS UP ITS BENCH

Will Billy Beane, the do-more-with-less general manager of the Oakland Athletics, lend NetSuite some of the magic he brings to his baseball team?

On Jan. 4, Beane became a director of the San Mateo (Calif.) company, which makes Internet-delivered business software. Naming an outside director signals the intention of nine-year-old NetSuite to go public this year. In 2006, it grew 60%, with \$70 million in revenues, 7,000 customers, and a positive cash flow. Still, it has yet to edge out crosstown rival Salesforce.com, which, with 27,000 customers, is the "damn Yankees" of the Internet software industry.

Beane's connection to NetSuite is with CEO Zach Nelson, whom he met a decade ago when McAfee Associates, Nelson's former employer, bought naming rights to the A's stadium. Nelson is "a little nervous" about having on his board a shake-'em-up GM like Beane, who was profiled in Michael Lewis' *Moneyball*. "But it will be a great experience to have somebody like that pushing me," he says. —Steve Hamm

GREEN BIZ

WAL-MART: LET THE SUN SHINE IN?

WAL-MART is falling for the sun. The retail behemoth last month put out a request for proposals to install solar panels at stores and distribution centers in five states, according to people who have seen the RFP. The project could take into account as many as 300 buildings and produce 150 megawatts of power, making the Wal-Mart installation the largest in the world, according to a solar industry executive who is one of the bidders.

Wal-Mart has confirmed it made the call for bids, but it won't comment on the details. The company is exploring solar energy as

a component of CEO Lee Scott's goal, announced a year ago, of eventually converting Wal-Mart's operations to 100% renewable energy. Among other things, the RFP asks vendors to outline how Wal-Mart could own its solar energy systems, lease them, or simply buy power from Wal-Mart roof panels owned by the solar company.

The company plans to notify the winner at the

end of February. Once it graduates from the exploratory phase and the capital costs involved might wind up balking at the ambitious project. But given Wal-Mart's sheer size, the solar industry executives installing panels on just of company buildings will still dwarf other corporate solar installation efforts, including the biggest in U.S.: Google's 1.6 megawatt project. —Heather



PATENT PENDING

NAME THAT NOISE

FROM AN APPLICATION to trademark a sound for use in slot machines, received by the U.S. Patent & Trademark Office in mid-December:

...a yell consisting of a series of approximately ten sounds, alternating between the chest and falsetto registers of the voice, as follows - 1) a semi-long sound in the chest register, 2) a short sound up an interval of one octave plus a fifth from the preceding sound, 3) a short sound down a Major 3rd from the preceding sound, 4) a short sound up a Major 3rd from the preceding sound, 5) a long sound down one octave plus a Major 3rd from the preceding sound, 6) a short sound up one octave from the preceding sound, 7) a short sound up a Major 3rd from the preceding sound, 8) a short sound down a Major 3rd from the preceding sound, 9) a short sound up a Major 3rd from the preceding sound, 10) a long sound down an octave plus a fifth from the preceding sound.

Filed by Fross Zelnick Lehrman & Zissu of New York, named by the Patent Office on Jan. 10 as the most prolific filer of trademark applications among all U.S. law firms. That was cause for a little chest-thumping at the firm. Still can't guess the sound sequence being described? See below.



any yell, already owned as a registered trademark by Fross Zelnick client Edgar Rice Burroughs Inc. for use in a Tarzan doll



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PUBLISHER'S ROW

THE WRITE STUFF ON A TOUGH BOSS?

BECAUSE SHE CAN, a novel written by a former ReganBooks editor, rode a prerelease wave of publicity back in December when renegade **Harper-Collins** publisher Judith Regan was fired. Now **Warner Books** is pushing up the publication date by a week, to Feb. 5, apparently to capitalize on the buzz surrounding Regan's downfall, legal battles, and putative comeback following her foiled plan to publish O.J. Simpson's *If I Did It*.

First-time novelist Bridie Clark worked for Regan for about a year in 2004. At the center of her book is one



Claire Truman, a young book publishing hopeful with a "notorious tyrant" of a boss, Vivian Grant. Industry insiders have pegged Regan as the inspiration for the ego-driven character with a taste for glamorous (and sometimes unsavory) authors. Warner says it pushed up the pub date to exploit "media interest" in

the book, not the Regan connection.

"It's not about Judith per se," says Karen Kosztolnyik, the book's editor.

"It's about anyone who's ever had an overly demanding boss." Reviewers (and Warner

publicists) compare the book to the 2003 best-seller and 2006 film *The Devil Wears Prada*. Does *Because* have the same franchise potential? Kosztolnyik says movie rights are still being shopped around. —Elizabeth Woyke

ARCHI-TECH

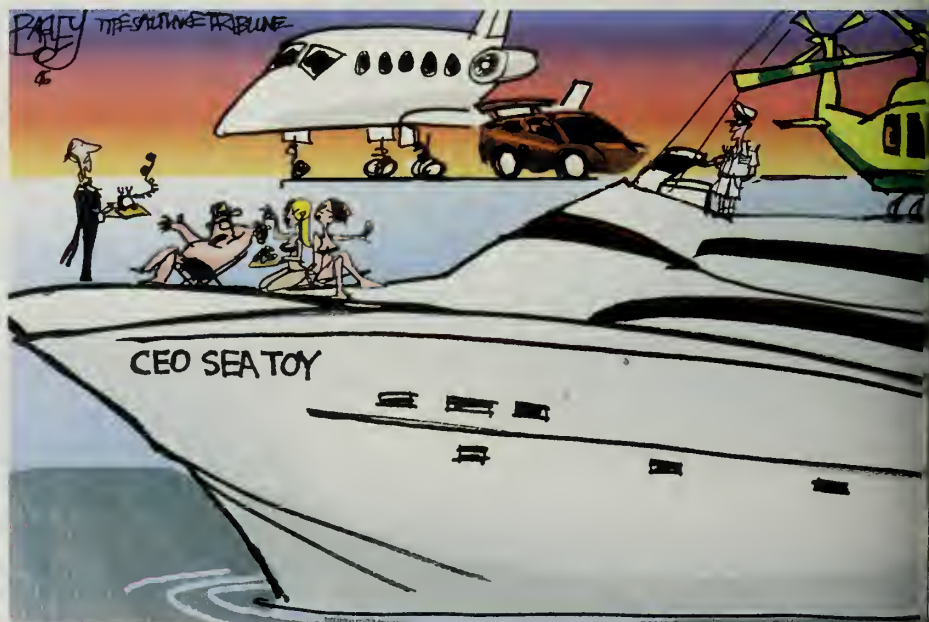
COME 2009, Dubai may be drawing iPod aficionados from across the globe. That is the expected completion

date for the **iPad**, a 23-story, \$800 million apartment building shaped like an iPod and tilted an iPod-like six degrees for anchoring a "docking station" (the building's base). The building, developed by Omniyat Properties in Dubai and designed by Hong Kong architectural firm James Law Cybernetics International, will have a futuristic glowing facade and apartments with high-tech devices built in, says firm Chairman James Law (who won't yet reveal those features). It won't be "just a piece of architecture," Law says, "but an integrated piece of technology and architecture." —Nichola Samina



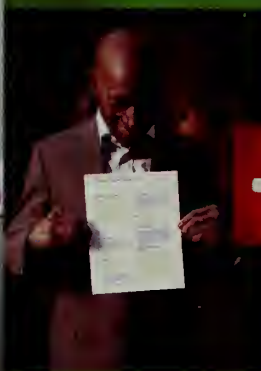
TRENDSPOTTING HELLO, GOODBYE

»**MANAGEMENT** turnover was way up in 2006. Exec-level churn—from directors down to VPs—rose 68% in 2006, to 28,058 changes. CEOs came and went at a 30% higher rate. CFO churn rose 23%. The drug/biotech industry saw the most CEO and CFO turnover. In biotech, these posts are often filled first by people able to handle "the initial development of the company," says Richard Jacovitz, a senior vice-president at **Liberum Research**, which did the study using SEC filings and press releases of North American publicly traded companies. But as biotech firms enter the marketing phase, he says, many "need a different sort of talent." —Lindsey Gerdes



"THAT WAS THE BOARD OF DIRECTORS FIRING ME FOR SCREWING UP THE COMPANY. THEY HAVE TO HUMILIATE ME WITH A \$100 MILLION SEVERANCE PACKAGE."

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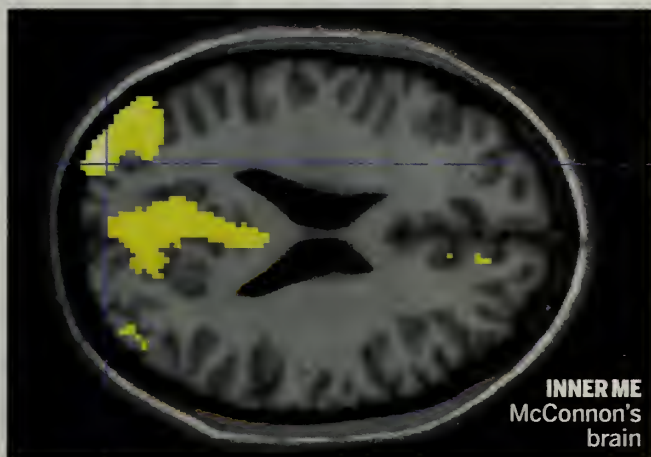
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INNER ME
McConnon's
brain

the brain for consumer insights isn't new. More than a dozen universities have been using fMRI to study how people respond to products (prompting Ralph Nader's Commercial Alert group to assert that "it's wrong to use a medical technology for marketing, not healing"). But now a few agencies like Arnold—whose clients also include McDonald's and Fidelity—and Digitas, another Boston-based shop, are offering fMRI research. "Neuromarketing" consultants, like Los Angeles-based FKF Applied Research, are springing up, too, to link

companies with hospitals seeking to lease time on their pricey MRI machines.

ADVERTISERS look to the scans to help tweak their messages. "If you're going to spend \$50 million on an ad campaign, wouldn't you want to know if the ad even gets out of the starting gate?" asks Joshua Freedman, M.D., who co-founded FKF. Because scans for 10 to 20 subjects can cost \$50,000 to \$100,000 (vs. \$4,000 for a focus group), FKF arranges fMRI time shares, allowing clients to show 10 subjects a 30-second ad for \$3,000, for instance.

Even that's too much for skeptics. "Just knowing the area of the brain where something fires doesn't tell you anything about why it fires," says Eric Du Plessis, author of *The Advertised Mind*. But Wightman argues that consumers often can't articulate what they like best. At McLean, she notes, the spring-break images sparked the most brain activity, even though the camping scenes were the spoken favorite. (Similarly, high-fat-food images fired up the brain of this reporter, despite her stated preference for photos of healthy snacks.) Since the McLean fMRIs were Arnold's first, the agency itself paid for them. (Brown-Forman says it might fund a future round.) Wightman concedes that responding to an ad while in an MRI device differs from shopping in a store. That's why she's also considering doing research with a sensor-equipped shirt, originally developed for medical tests, that records rises in sweating or heartbeat as the wearer responds to a product.

—Aili McConnon

ESTION OF E WEEK

ota is poised to
ome the world's
1 carmaker.
ould the U.S. do
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d Kiley

"If the goal is to create jobs, why should Washington prioritize Americans working for Ford in Kentucky over Toyota's Americans in Kentucky? Are those who work for Toyota less American than those working for Ford or GM?"

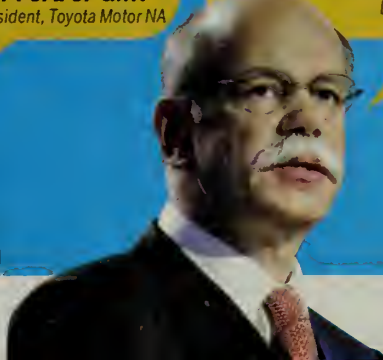
Jim Press, president, Toyota Motor NA

"I wouldn't base my plans on expecting change. But if I had a wish, it would be for the government to pass health-care policy that would place far less of the burden on companies."

Dieter Zetsche, chairman,
DaimlerChrysler

"Health-care reform. But, politically, that's like trying to boil the ocean. So I'd like Washington to invest much more to help with our plans to make more fuel-efficient vehicles."

Mark Fields, president of the
Americas, Ford Motor



The most fuel-efficient aut



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†Civic Hybrid and Fit Sport with SMT shown. 2007 EPA mileage estimates: 49 city/51 highway, 33 city/38 highway, respectively. Use for comparison purposes only. Actual mileage may vary. ©2006 American Honda Motor Co., Inc. environmentology.honda.com

ompany in America.*



HONDA
The Power of Dreams

“It is a statistical fact that 70% to 80% of money managers often fail to beat the [S&P 500] index’s market returns.”

—Srinivas Balla
Arlington, Va.



approach of the current U.S. mo- tantamount to an ill-tempered p smacking a baby. With communie ineptitude like this, Paulson di- deserve the hearing he got from Chinese.

—Marcus
Associate Professor, Communie
Northeastern Uni

HANK PAULSON HAS NO BUSINESS LECTURING THE CHINESE

“HANK PAULSON on China and the year ahead” (Face Time, Dec. 25/ Jan. 1) provides further evidence of why the current Administration is consistently underperforming in its policymaking. For starters, [Treasury Secretary] Paulson is a nonpolicy specialist whose expertise is in making vast amounts of money, not in thinking through and creatively suggesting solutions to the financial challenges this Administration has wantonly produced.

More pressingly, Paulson is inept

as a communicator. His near-perverse suggestion that China should “speed up the pace of reforms because...they’re somewhere between a market-driven economy and [a managed economy]... and that’ll get them nowhere” is a logical fallacy. Last time I checked, the Chinese had a gross domestic product that is up 10%, industrial production that is up 14%, a trade balance of more than \$163 billion for the past year, a current-account upside of \$160 billion, and foreign reserves above \$987 billion.

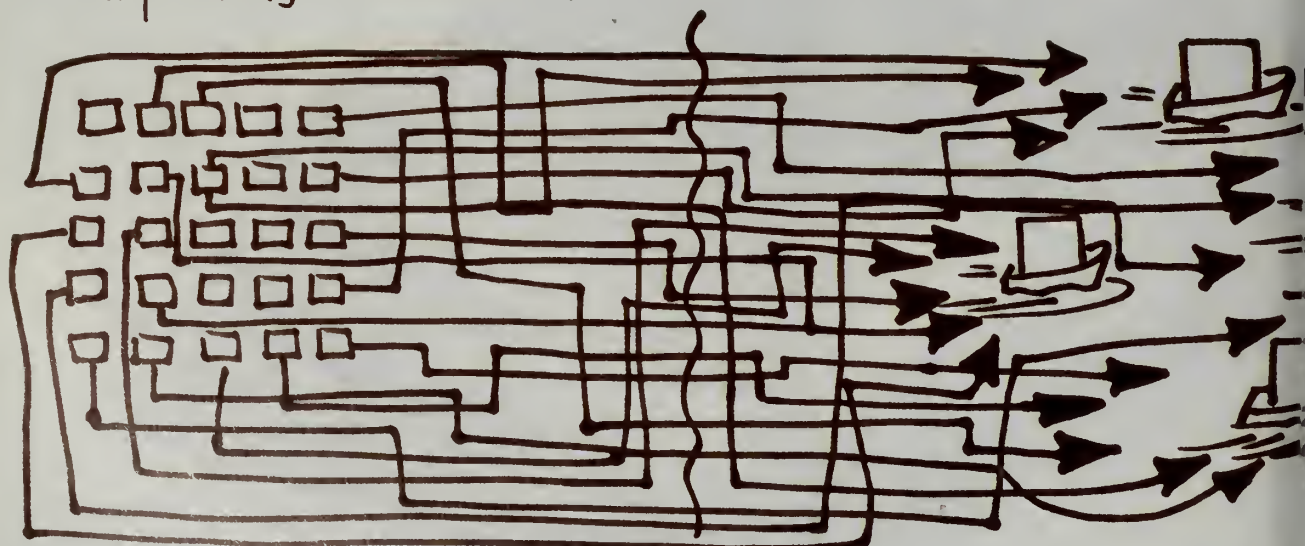
The audacity of telling Chinese officials to drop their mixed, even quasi-managed economy for the free-market

ONCE MORE WITH FEELING: STEER CLEAR OF STOCKPICKER

“WHERE TO INVEST 2007” (Story, Dec. 25/Jan. 1) promised to “plan a winning strategy for the year, whatever your investment n Fascinating, I must say. But what happened to the good old aca- mantra of investing on the Sta & Poor’s 500-stock index and no- ing to worry about selecting s- stocks? It is a statistical fact tha- to 80% of money managers ofte- to beat the index’s market re- Do you consider yourself with- other 20%?

—Sriniva-
Arlingt-
ge

Importing



AND FORECLOSURE: ON ONE BEGS TO DIFFER

FORECLOSURE FACTORIES' vise" & Insights, Dec. 25/Jan. 1) was to mention a mortgage foreclosure experienced by borrowers had a loan with our company. Absolutely no association between the borrowers' situation and the premise that mortgage services using predatory tactics to harm borrowers.

Article grossly misrepresents, sole-ly charges and attorney fees, and it states was owed on the loan. It is, the actual amount owed would consist almost entirely of past-due principal and interest and amounts added on the borrowers' behalf for real estate taxes and insurance. The borrowers received and signed disclosures from the lender as well as additional plain-language disclosures from Option One indicating that they understood an adjustable-rate mortgage works, contrary to what the article contends.

One wins when a borrower loses a home. As a top-rated servicer, Option One does the right things to help the borrower get back on track toward curing

their loan default and repaying their debt.

While the reasons for foreclosures, such as bankruptcy, job loss, and divorce, remain outside the control of the servicer, there are remedies. At Option One we will continue to focus on keeping people in their homes through early intervention, workout plans, and a compassionate, humane approach.

-Teji Singh

Chief Servicing Officer
Option One Mortgage Corp.
Irvine, Calif.

CORRECTIONS & CLARIFICATIONS

"Is Steve Jobs untouchable?" (News & Insights, Jan. 15) incorrectly said that Apple Inc. co-founder Steven P. Jobs is chairman of Apple's board. He is CEO and a board member but not chairman. At the time of the options backdating that Apple disclosed on Dec. 29 in its annual report, Apple did not have a chairman. But Apple's bylaws at the time stipulated that Jobs, in his capacity as CEO, preside over board meetings.

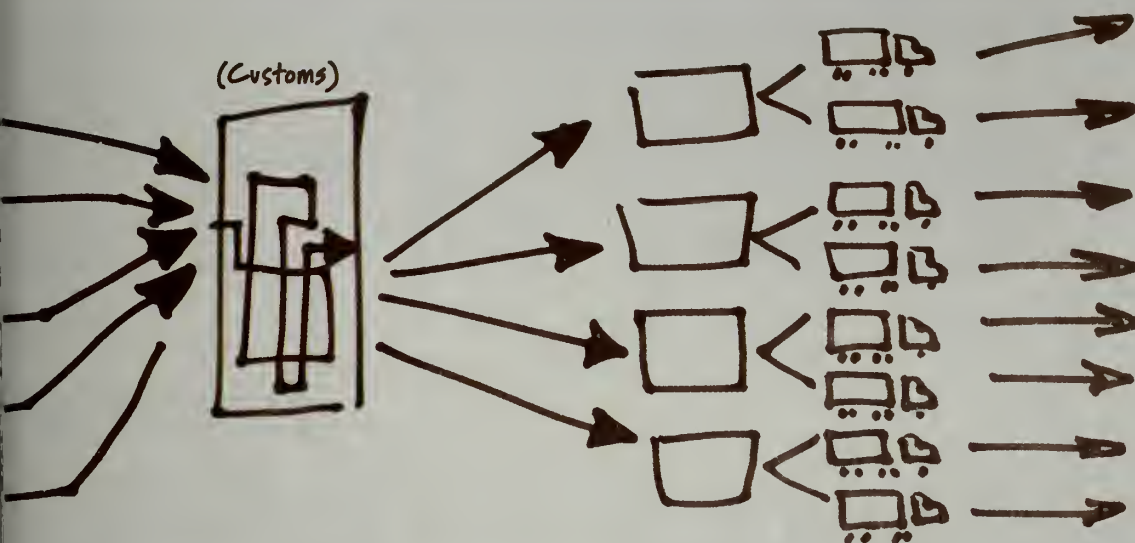
"Bankruptcy becomes Delphi" (News & Insights, Jan. 15) should have noted

that Highland Capital Management's offer to buy Delphi Corp. out of bankruptcy includes a provision that all current shareholders can maintain their stakes in the reorganized company.

"China: Falling hard for Web 2.0" (Info Tech, Jan. 15) misstated the name of the venture capital firm backing Internet company Qihoo. The correct name is Highland Capital Partners (unrelated to Highland Capital Management mentioned above).

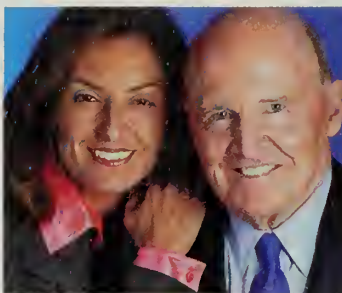
ALLERGAN'S MARKETING BLITZ WON'T SWAY SMART WOMEN

YOUR ARTICLE IS TITLED "Silicone goes subtle" (News & Insights, Dec. 25/Jan. 1), yet Allergan's marketing as outlined within is anything but. It includes Web sites with links to positive studies and an "ask the nurse" feature, a public relations "blitz" (your word, not mine) targeting editors of women's magazines, and a print campaign. The company is also poaching employees from Nestlé and Procter & Gamble as if selling sili-



“Choosing a model of corporate governance is now every board’s challenge.”

—Alan Towers
New York



Up Front, Dec. 25/Jan.1). I suppose the implied standard, uncovering against shareholders is simply sour grapes from those who weren't quick enough to have already cheated.

It would be helpful to invite others if *BusinessWeek* publishes an annual list of “Liars, Cheaters & Thieves.” After all, anyone willing to cheat the federal government is certainly waiting for an opportunity to cheat shareholders, business partners, and the general public.

The list could serve as a warning. Prosecution has proved insufficient to deter fraudulent behavior, but perhaps being shunned by investors and the public might work.

—Patrick Du
Covington

cone breast implants were as innocuous as hawking candy and toothpaste.

Citing new studies that support the Food & Drug Administration’s lifting of the 14-year moratorium, Allergan is attempting to push its product on well-educated women with the tagline “You’ve never looked smarter.” But is it smart to believe only the results of the latest studies? Intelligent people know that all studies are suspect and that you can find one to support whatever theory you want to promote. And do women need bigger boobs to feel smart, to themselves and others?

Intelligent people know there is

no correlation between gray matter and externals. And finally, women’s experience with being experimented on by the medical Establishment makes it unlikely that they will be suckered again. Can you say “hormone replacement”?

—Karen Ann DeLuca
Alexandria, Va.

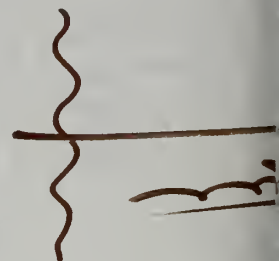
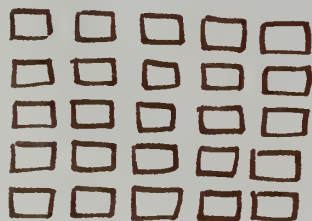
LET’S NAME THE LIARS, CHEATERS, AND THIEVES

IT’S INTERESTING that former House Majority Leader John Boehner (R-Ohio) characterizes proposed investigations into fraud in Iraq contracts as “revenge” by the Democrats (“Give-’em-hell Nancy?”

ARE CORPORATIONS DEMOCRACIES OR DICTATORSHIPS?

IF THE CORPORATION is a democracy, its owners, then anti-Wal-Mart union organizers have just as much right to the Wal-Mart Stores boardroom as they do in Congress, if they can get elected. (“The boardroom bunker,” *The New York Times*, Dec. 25/Jan. 1).

Importing w/UPS



le those in power never enjoy
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irectors should be prepared for
iscomfort.

—Alan Towers
President
TowersGroup Inc.
New York

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BusinessWeek

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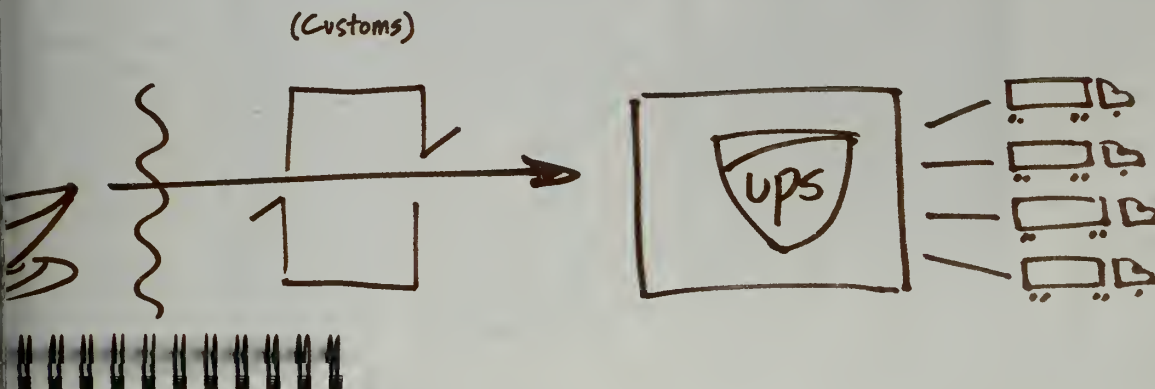
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WHAT CAN BROWN DO FOR YOU?®





Burglar-Proof Windows?

The Microsoft marketing hoopla set off by the Jan. 30 launch of Windows Vista will focus on the software's spiffy new look and enhancements such as greatly improved search abilities (BW—Jan. 15). But the really important changes, mostly hidden, aim to improve Windows' leaky security. What you see of this may be annoying, but trust me, it's good for you.

One big reason Windows has been so vulnerable over the past 15 years is that Microsoft chose to make things easy when faced with a trade-off between security and convenience. But in recent years, as Windows users have grown increasingly outraged by nonstop hacker attacks, Microsoft's attitude has evolved. The company originally intended to base Vista on Windows XP but scrapped that idea a couple of years ago. Instead, it resolved to work off the much more secure foundation of Windows Server 2003. The Server version has generally won good marks for security.

All operating systems have security holes, and Vista will be no exception: One potential vulnerability has already been identified by security experts. The difference is that the holes in Vista should be much harder for the bad guys to exploit, compared with earlier versions of Windows.

A couple of protective features introduced in Windows XP have been expanded in Vista. Windows Defender, an anti-spyware program that was a free download for XP, is built into the new version. And the Windows Firewall is much enhanced. The XP version could block incoming attacks, but the Vista edition watches traffic both in and out of your system, which can help stop malicious programs from stealing data or spewing spam e-mails.

THE CHANGE YOU WILL NOTICE MOST is called user account control. Mac owners have long been used to Apple's OS X asking their permission before installing any software. This is a good thing. Microsoft, similarly, tried to clean up its act in 2004 with a major upgrade to XP called Service Pack 2, and again with Internet Explorer 7 last fall. But Windows has always been promiscuous about loading software from dubious sources without asking questions.

No more. Vista won't install anything, from any source, without explicit permission. (You can turn account control off in a control panel, but it's not wise.) To let an installation proceed, you will have to either click a button to give permission or supply a password, depending on how your



account was set up. Among other things, Vista allows you to set up restricted accounts for your kids to keep them from downloading software to your computer without your password.

But some work needs to be done, especially by third-party software suppliers, to keep account control from driving you nuts. For example, every time I start up, the Logitech mouse software wants to check the Web for updates—and triggers an alert. So

a test version of Norton AntiVirus. Eliminating these false alarms will encourage users to pay attention to the warnings rather than just reflexively clicking "No." Stopping to think for a moment before permitting an installation can help keep Windows more secure.

Versions of Vista designed for corporate use include a feature called BitLocker that allows simple but strong encryption of hard-drive contents. It's likely

The new security features may be annoying, but they're good for you

make its way eventually to home versions, too, but only if a required piece of hardware, called a Trusted Computing Module, becomes common in consumer desktops and laptops.

I'm usually the last person to salute anything that makes life more complicated for computer users. But in the case of Vista, a little inconvenience up front can save you a lot of grief that malicious software and other attacks can cause. Long-overdue security enhancements are bound to irritate some users, but they're all for the best. ■

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“ Migrating from UNIX to Linux is no simple feat. ”



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Creative, But Gentle, Disrupter

One very genial, very excited gadget geek—that pasty indoor pallor may be explained by the seven TVs in his apartment—is practically bouncing up and down in front of his laptop. As he watches a live basketball game on the screen, he records key plays on the fly and e-mails Web links to the video snippets to his pal. The glee is understandable; the technology cannot help but impress.

Then again, he is adding weight to the cement shoes of those who'd prefer to keep TV more or less as it is.

The snip-and-clip guy, Jason Hirschhorn, spent years inside a traditional media company—his last position was chief digital officer of MTV Networks, where his job was to figure out how MTV would survive in a YouTube-ing world. Today, he's president of Sling Media Entertainment Group.

Sling Media sells the Slingbox, which wirelessly beams programs from your TV to your laptop or cell phone via the wonders of broadband. TiVo, and digital videorecorders like it, time-shift TV programming; the Sling Box and similar devices place-shift TV so you can watch local programming anywhere in the world. This, like many other recent developments, is good for overall TV consumption while being very, very bad for key parts of the TV equation. (For starters, local TV station owners and cable systems have business models built around hitting consumers in specific geographic locations.)

SLING UPPED THE ANTE during the annual January geekathon known as the Consumer Electronics Show by announcing two major developments: the pending release of the SlingCatcher, which makes Sling's technology two-way and lets Web video—from video clips to movie downloads—be viewed on your TV; and the Clip + Sling technology, the snippet-snatch-and-send function that had Hirschhorn so hopped up. Hirschhorn's job is to build out a Sling-branded video destination site and, most important, to convince the kind of people he used to work with that Sling is friendly, not fanged. That CBS CEO Les Moonves demonstrated Clip + Sling onstage during his CES keynote suggests the degree to which guys like Hirschhorn and gadgets like his are leading the way at this media moment.

Technology is busy blowing up your video (if I may recast a phrase first used by AC/DC) as it has done, or is doing, with virtually every other media form. This does



Sling is happy to placate media's jittery giants

not make Hirschhorn's char easy. Sling may seek to be the next Apple—the disrupter with a friendly face. (Or since Steve Jobs has unleashed Apple TV, which pushes online video to your television, a more apt metaphor for Sling might be the non-Apple—in the way that Democratic Presidential candidates jostle to be the next Hillary.) But Sling is also trying to move from threat to partner without Apple's bona fides or Google's omnipresence. For this, Hirschhorn's past helps: He understands the paranoia that media companies have about their content," he says.

His argument is that Sling can help them figure out how to thrive in the "click culture" of today. He suggests Sling data on viewer habits will prove valuable if shared with

media companies. (The most clipped parts of a sitcom, for example, offer a road map to which supporting characters on a show deserve a higher profile.) There's the potential for ad revenue-sharing on its upcoming video site, which will be built around the video streams that get Clipped + Slung—once, that is, ads and revenue are there. Its first partner: Moonves' CBS, which will beta-test Clip + Sling.

It may or may not make sense for the networks to get in bed with Sling—which, by bringing Web video to the living room, threatens to further erode their monopoly on television. But, as with much else these days, the traditional players have no choice: The details of the victory are uncertain, but the gadget geeks are winning. ■

BusinessWeek .com For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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JAMES C. COOPER

Strong Job Markets Dash Hopes For Rate Cuts

Payrolls show the economy is poised to pick up, not weaken further

U.S. ECONOMY The Labor Dept.'s monthly roundup of job market activity has always been the economic report Wall Street listens to more than any other. It's a market-mover because of its timeliness, breadth of coverage, and its influence over policymakers at the Federal Reserve. What investors heard from the surprisingly strong

November data on Jan. 5 was a death knell for hopes the Federal Reserve would be cutting interest rates in 2007. The markets, which have been building in expectations of rate cuts for months, promptly tanked. The report, which showed December payrolls rose by 100,000, along with upward revisions to gains in October and November, was a watershed, at least for perceptions of the economy's current strength and near-term prospects. The broad gains in the labor markets at yearend ran counter to some recent downbeat reports portraying the economy as on the verge of succumbing to the housing recession and softness in manufacturing. The labor strength provided powerful evidence that the weakness in those two sectors remains isolated—and is likely to stay that way. Outside of construction and manufacturing, job growth in the second half of 2006 was even faster than in the first half. Job markets were tight enough to push the unemployment rate at 4.5% last month, only above October's 5½-year low of 4.4%. The labor market simply businesses are not retrenching but remain optimistic enough about future demand to continue to raise their payrolls. They also show, despite retailers' complaints over holiday sales, a labor market strong enough to generate the income gains necessary to fuel consumers spending at a healthy clip (chart). Combined with gathering signs that the slowdowns in housing and manufacturing will be easing in the first half of 2007, the latest job report hardly portrays the economy soon in need of lower interest rates. Just the opposite. Once those drags ease, overall growth is expected to rebound as the economy's underlying strength asserts itself. In fact, the job report supports the Fed's talk of late: The bigger risk to the economy down the road is not weak growth but accelerating inflation.

EXPECTATIONS OF LOWER RATES have always been tied to weaker consumer spending, which in turn led to slowdowns in corporate hiring and capital spending. December's strong labor markets throw cold water on that scenario. Solid gains in jobs and incomes in December, along with lower energy prices, suggest why real consumer spending appears to have

grown last quarter by about 4%, at an annual rate—a strong showing by any benchmark.

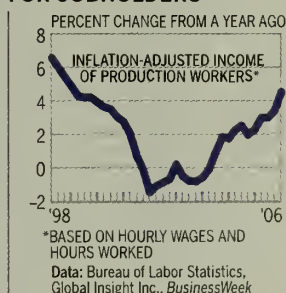
In December, traditional retailers sounded down-in-the-mouth about their holiday sales, with receipts up only 3.1% from a year ago. However, that modest showing partly reflects a couple of new trends that don't fully show up in the regular holiday numbers. First of all, through Dec. 26, Internet sales at U.S. sites for nontravel items during the holiday season were up 26% from a year ago, to \$23.2 billion, according to an estimate by comScore Networks. The company says retail e-commerce outside of gas, autos, and food now accounts for about 7% of all retail outlays.

Second, gift-card sales are booming, a trend that boosts January receipts, often at the expense of retailers' December numbers. Prior to the holidays, the National Retail Federation Gift Card Survey projected a 34% jump in card buying from the previous year, to \$24.8 billion. Those sales won't show up in a big way until January, when the cards are redeemed. The International Council of Shopping Centers says this pattern is lifting the annual importance of retailers' January sales,

noting that gift-card redemptions could drive about 20% of this month's industrywide receipts.

AMID RESILIENT CONSUMER DEMAND, it's not surprising businesses are shedding some of last summer's concern over the outlook. CEO confidence improved moderately in the fourth quarter after having fallen to a five-year low in the third quarter, according to a Conference Board survey. Those results jibe not only with recent hiring gains but also with other reports last quarter showing strength in capital spending. Through November, production of business equipment was

MORE BUYING POWER FOR JOBHOLDERS



making solid advances, and outlays for new business construction were still in an uptrend. Even if businesses are a little more uncertain about the outlook, they have not materially altered their spending and hiring behavior.

With businesses expanding payrolls, consumer spending is getting lots of support from income growth. Average hourly pay of production workers in December grew 4.2% from a year ago, up from the 3.2% growth rate this time last year. At the same time, inflation has fallen, boosting buying power. With more people at work, overall income growth is also impressive. Based on the employment report's data on hourly wages and hours worked, income of production workers last quarter was up 6.4% from a year ago. Adjusted for inflation, the pace was the strongest since the boom of the late 1990s.

WHILE THE ACCELERATION in wage growth is great for consumers, it is not so comforting to the Fed. With labor markets tight enough to keep upward pressure on wages, the Fed is not about to cut interest rates for fear that easier credit conditions would only increase demand, further tightening job markets, and add new cost pressures that could eventually push up inflation.

Somewhat surprisingly, the labor markets have shown no hint of loosening despite the economic slowdown. After growing at a heady 5.6% annual rate in the first quarter of 2006, the economy posted modest gains of 2% in the third quarter and 2.6% in the second. Yet the jobless rate still managed to fall from 4.8% in July to 4.5% in December.

However, the current degree of tightness in the labor market is no reason to believe the Fed will have to hike

interest rates—at least not yet. Overall labor costs are being held down by a reduction in benefit payouts, which largely reflects a sharp deceleration in health costs. Also, the increase in average hourly pay is par because a lot of the recent payroll additions have been higher-paying service jobs. For example, business and

professional service accounted for more than 30% of the gain in overall payrolls during the fourth quarter.

Improving employment prospects also are preventing job market from tightening too rapidly by drawing in potential workers in the workforce. The labor force participation rate, which is the percent

MORE PEOPLE ENTER THE WORKFORCE



of the adult population either employed or looking for work, jumped sharply during 2006, to a 3½-year high of 66.4% (chart). The more people there are in the job market, the less downward pressure on the jobless rate.

So the latest job data actually have two messages for investors. First, don't expect rate cuts, but don't be too morose: The numbers don't suggest any immediate need for the Fed to begin hiking rates. Now, at least, the economy appears to be in a sweet spot: decent growth with ebbing inflation and the Fed watching from the sidelines. ■

GLOBAL EMPLOYMENT

Where the Jobs Are: Everywhere

THE LABOR MARKET is heating up across the globe. Businesses in developed and emerging economies alike are adding workers at a rapid clip as the global economy keeps expanding. If the hiring trend persists, it could have important implications for the U.S. economy.

Employment growth outside America is at its fastest rate since

2000. According to JPMorgan Chase & Co., in September, 2006, the latest period available, overall job growth in 18 countries was up 1.8% from the previous year. The pace is also better than in the U.S., where employment in December was up 1.4% from a year ago.

Early returns on job figures during the fourth quarter remain strong around the globe. The most recent job reports from Canada, Argentina, Australia, and Britain were positive, and the outlooks for employment remain upbeat as well. In Brazil, for example, the Institute of Applied Economic Research, a government-run public foundation, is forecasting

job growth of no less than 2.7% for 2007.

In addition to continued hiring, JPMorgan Chase economist David Hensley wrote in a Jan. 8 research note, "We look for a broader acceleration in wage growth in 2007 as unemployment rates fall further

and companies compete more aggressively to fill positions." That bodes well for U.S. multinationals and exporters. Tighter labor markets should lead to stronger consumer demand, which would boost business activity and investment spending.

But signs of accelerating wage gains will also lead to higher rates, says Hensley: Central banks in Britain, Canada, and the Scandinavian countries would raise rates in response to faster wage gains, but the "European Central Bank also will be sensitive to signs that wage growth has turned too hot."

If the Federal Reserve holds rates steady as hikes abroad occur, the dollar could face greater downward pressure. That would make American-made goods more attractive abroad and fatten profits earned outside the U.S. when they are turned into greenbacks. ■

—By James Mehring in New York

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The Business Week

News you need to know

EDITED BY HARRY MAURER



Cheaper Black Gold That midsummer nightmare—oil prices near \$80 a barrel—feels long ago and far away. Crude prices have tumbled nearly a third from their July peak. On Jan. 10 the price plunged \$1.62, to \$54.02, on the *New York Merc* after the **Energy Dept.** reported the biggest surge in three years in inventories of distillate fuel, the category that includes heating oil.

Is warm winter weather behind oil's slide? That's part of it, but only about 7% of oil is used for heating. Other factors include slower economic growth and cheating by **OPEC** members on their production-cutting deal (a Jakarta depot, photo). Plus, Belarus reported progress on Jan. 10 in a spat that halted shipments of Russian oil across its territory to Europe. In any case, for oil-consuming nations (and that's most of us), less pricey oil is as good as a tax cut.

ONLINE See "The oil market's weather obsession," www.businessweek.com/go/tbw

The Health Governorator Maybe it was because he broke his leg skiing over Christmas, but three days after he was sworn in to a second term as California's governor, **Arnold Schwarzenegger** proposed offering health-care coverage to the state's 6.5 million uninsured residents. The plan, costing an estimated \$12 billion a year, would be funded by businesses, doctors, and hospitals. Conservative lawmakers are expected to challenge it as an open-ended tax. The move would make California one of four states to provide universal coverage and will shine a spotlight on the issue in the 2008 Presidential election season.

Phonemakers Tremble As is his wont, Steve Jobs' tongues wagging around the globe on Jan. 9 when he announced the forthcoming iPhone, a music, camera, Internet, video, and cell-phone combo. He also portended dropping "Computer" from Apple's corporate name.

See "Turning cell phones on their ear," page 40.
ONLINE "The future of Apple," www.businessweek.com/go

A Slimmer Trade Gap Could the seemingly inexorable decline in America's competitive position be ending? November trade deficit in goods and services, released Jan. 10, was \$58.2 billion, the lowest since July, 2005. More encouraging are glimmerings of a turnaround in the nonoil trade gap, which isn't influenced by the recent rise in crude prices. The nonoil deficit, averaged over the previous 12 months, actually shrank in November compared with the 12 months ending in October. That's a cheery sign since it has expanded in 55 out of the past 57 months.

Gap up for Grabs After years spent struggling to shed more jeans and tees, Gap is trying to sell itself. On Jan. 10, **CNBC** reported the giant chain has hired **Goldman Sachs** to seek a buyer, driving Gap shares up 7.25%, to \$20.26. Analysts say any potential bidder would be a private equity group rather than another specialty retailer, which would have trouble digesting Gap's thousand stores, including **Banana Republic**, **Old Navy**, and Gap stores. Gap and Goldman Sachs declined to comment. On Jan. 10, the head of Gap's advertising and Old Navy's design chief announced their exits.

ONLINE See "Gap on the block," www.businessweek.com/go

Patent Wars A Supreme Court ruling has the patent world buzzing. In 1997 biotech **MedImmune** licensed technology from **Genentech** to make a drug used to prevent respiratory illness in children, but did so under protest, claiming Genentech's patent was invalid. On Jan. 9 the justices ruled MedImmune didn't have to terminate the license—and pay huge damages for infringement—to go to court and void the patent. The case now goes back to a trial for resolution, while attorneys light up the Internet with speculation whether it will make it easier for other patent licensees to bring challenges.

Dogfight Over Delta Decisions, decisions. **Delta Airlines** may have yet another way out of Chapter 11: hooking up with the other big boy in bankruptcy, **Northwest**. Delta had insisted it wanted to emerge as an independent, spurning an \$8.4 billion takeover bid from **US Airways** last fall. But **Airways** may have made that course impossible on Jan. 10 by boosting its offer to \$10 billion. While Delta management was just saying no publicly, however, it has been in talks with Northwest about a merger, reported *The Wall Street Journal* on Jan. 10. Time is of the essence: Northwest plans to reorganization plan in court on Jan. 16. The maneuvers are as **United** and **Continental** explore a combo of their own.

ONLINE See "Delta's 'leave-us-alone' plan just got tricky," www.businessweek.com/go

Plastics Auction It's hard to make money in plastic these days, so **General Electric** wants out. It has put its plastics unit up for auction—with the caveat that the equity firms might not be able to team up for a bid. Reason, first reported in *The Wall Street Journal* on Jan. 10, to abate growing antitrust concerns over private equity bids. But the company also wants as many bidders in the party as possible. GE is likely less concerned about the price than its own bottom line.

Executive Shuffle The king has a new throne, but his crown is less bejeweled. Nine months after abdicating as CEO of **Burger King**, saying he wanted to spend more time with his family, **Gregory Brenneman** on Jan. 8 was named CEO of sandwich chain **Quiznos**. Other notable managers moving: **Stephen Jonas**, who revamped **Fidelity Investment's** mutual fund unit, will retire at the end of January; and **Lawrence**, head of global sourcing at **Wal-Mart**, quit on Jan. 9. In nine months in the job, the fourth top-rank exec to leave since December.

Stern's Latest Bonanza Shock jock and stripper aficionado **Howard Stern** should have no problem this year paying his bonus. His employer, **Sirius Satellite Radio**, said on Jan. 9 that Stern will be given stock valued at \$83 million because the company beat subscriber targets for 2006. Before Stern was hired, Sirius expected to have 3.5 million subscribers by the end of 2006, but it ended up with 6 million. The bonus was worth the \$500 million, five-year contract Stern signed in 2005. Meanwhile, Sirius and its chief rival, **XM Satellite Radio**, are bleeding red ink, while Sirius stock sank 40% over the year. On Jan. 10, Sirius CEO **Mel Karmazin** said a merger with XM would make sense, and both stocks jumped.

Bombshell of the Week

Venezuelan President Hugo Chávez sure knows how to throw money into the financial markets. When the leftist leader announced on Jan. 8 that he intends to nationalize a number of utilities, it raised the possibility that Mexican tycoon **Carlos Slim** would walk away from a deal to buy the nation's largest telecom provider, **CANTV**. Last April, Verizon announced a plan to acquire a 28.5% stake in CANTV for \$676.6 million. The deal was to be a company jointly owned by **Teléfonos de México**, Mexico's big telco, and **América Móvil**, a Latin American wireless outfit. Slim, the world's third-richest man, controls both of those companies. The Chávez announcement crushed CANTV's value: By Jan. 10, its stock had fallen 29%, to \$14. On paper, Verizon's stake was worth a mere \$441 million.



CHAVEZ—DEALBREAKER?

ONLINE See "Venezuela's Chávez rattles markets," www.businessweek.com/go/tbw

Sprint's mobile broadband works in places Cingular's can't raise a single bar.

Sprint Mobile Broadband works in 2x more cities than Cingular's BroadbandConnect.



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Sprint Mobile Broadband Network reaches over 180 million people. Coverage not available everywhere—see map for details. Coverage comparison based on most recent available information regarding Cingular broadband market coverage as of 11/27/06. Offer not available in all markets/locations. Subject to credit approval. Additional restrictions apply. Requires purchase by 2/17/07 and activation by 3/3/07 of a new line on Unlimited Data Plan (\$59.99) and two-year agreement. \$36 activation fee and \$200 early termination fee apply. Mail-in Rebate: Rebates cannot exceed purchase price. Taxes excluded. Line must be active 30 consecutive days. Allow 8–12 weeks for rebate. ©2007 Sprint Nextel. All rights reserved. Sprint, the "Going Forward" logo and other trademarks are trademarks of Sprint Nextel.

GOVERNANCE

BOARD OF HARD KNOCKS

Activist shareholders, tougher rules, and anger over CEO pay have put directors on the hot seat

BY NANETTE BYRNES AND JANE SASSEEN



JUST FIVE YEARS AGO, THE Directors' College run by the Stanford Law School was a pretty tiny affair. If the three-and-a-half-day training program drew even 100 people, that was big. But in wake of the corporate scandals, board members realized they needed to bone up everything from financial accounting to governance, and applications exploded. Stanford has since enlarged the program to 250 slots. This year, it also added a one-yearly session in conjunction with the Graduate School of Business that will attract an additional 100 attendees.

Even with this expansion, last year's session sold out months in advance. And this year's openings are filling up even faster. "The pressures on boards

are already great, and they are only going to grow," says Joseph A. Grundfest, co-director of the university's Rock Center for Corporate Governance.

A new era for directors dawned with the passage of the Sarbanes-Oxley Act of 2002. Then board members were hit with the frightening prospect of real financial liability in a smattering of lawsuits that followed the corporate crime wave. Now the heat on directors is growing more intense. Their reputations are increasingly at risk when the companies they watch over are tainted by scandal. Their judgment is being questioned by activist shareholders outraged by sky-high pay packages. And investors and regulators are subjecting their actions to higher scrutiny. Long gone are the days when a director could get away with a

quick rubber-stamp of a CEO's plans.

The new dynamic has played out in recent board dramas involving Home Depot, Hewlett-Packard, and Morgan Stanley, among others. If Home Depot's directors had any hope that the spotlight on them would fade in the wake of departure of ex-CEO Robert L. Nardelli on Jan. 3, they now know better. Unhappy investors are continuing to agitate for new blood in the company's boardroom. "The culpability is not on the CEO for asking [for high pay] but the directors" for approving it, says Richard Ferlauto, director of pensions and benefits policy for the American Federation of State, County & Municipal Employees, one of the more vocal investment funds putting pressure on Home Depot's board. "Compensation is a symptom. It flags for us a board



that is unwilling to challenge a CEO."

And that just won't do. The old rules of civility that discouraged directors from asking managers tough or embarrassing questions are eroding. At the same time, board members are being forced to devote more time and energy to many of their most important duties: setting CEO compensation, overseeing the auditing of financial statements, and, when needed, investigating crises. That's the good news. The bad news is they are so busy delving into the minutiae of compliance that they don't have nearly as much time to advise corporate chieftains on strategy. Many board candidates no longer find the job

attractive. "If someone has accumulated a lot of wealth, they just don't think it's worth the risk," says retired General Hugh Shelton, the former chairman of the Joint Chiefs of Staff who now heads the compensation committee at Red Hat Inc.

The latest luminary to sound off about the situation is Jim Clark, who resigned from the board of photography Web site Shutterfly Inc. on Jan. 8. "I basically kept that company alive. I hired the CEO and have been involved in every step," said Clark in an interview two days later. Because he owns 30% of the company, however, new rules on director independence limit his role on important board commit-

tees. "Being on the board of directors of a public company has already got a risk. And I have all these constraints that essentially no power."

The hottest issue for boards this year is shaping up to be executive compensation. For the first time ever, companies are required to disclose a complete tally of everything they have promised to pay executives, including such until now hidden or difficult-to-find items as severance pay, deferred pay, accumulated pension benefits, and perks worth more than \$10 million. They will also have to provide an explanation of how and why they've chosen to pay executives as they do. The number

PLAYBOOK: BEST-PRACTICE IDEAS

The New Rules For Directors

PAY

Companies will disclose full details of CEO payouts for the first time in their 2007 SEC filings. Activist investors are already drawing up hit lists of companies where CEO paychecks are out of step with performance.

KNOW THE MATH

Before O.K.'ing any financial package, directors must make sure they can explain the numbers. They need to adopt the mindset of an activist investor and ask, What's the harshest criticism someone could make about this package?

STRATEGY

Boards have been so focused on compliance that duties like strategy and leadership oversight too often get short shrift. Only 59% of directors in a recent study rated their board favorably on setting strategy.

MAKE IT A PRIORITY

To avoid spending too much time on compliance issues, strategy has to move up to the beginning of the meeting. Annual one-, two- or three-day off-site meetings on strategy alone are becoming standard for good boards.

FINANCIALS

Although 95% of directors in the recent study said they were doing a good job of monitoring financials, the number of earnings restatements hit a new high in 2006, after breaking records in 2004 and 2005.

PUT IN THE TIME

Even nonfinancial board members need to monitor the numbers and keep a close eye on cash flows. Audit committee members: prepare to spend 300 hours a year on committee responsibilities.

CRISIS MANAGEMENT

Some 120 companies are under scrutiny for options backdating, and the 100 largest companies have replaced 56 CEOs in the past five years, nearly double the terminations in the prior five years.

DIG IN

The increased scrutiny on boards means that a perfunctory review will not suffice if a scandal strikes. Directors can no longer afford to defer to management in a crisis. They must roll up their sleeves and move into watchdog mode.

FED UP Jim Clark's frustration at Shutterfly drove him off the board



likely to be eye-popping. Michael S. Melbin, a top compensation consultant in Chicago, thinks when all the proxies are filed, there could be a rash of companies or more CEO pay packages worth \$150 million-plus.

And this is, believe it or not, coming as a big surprise to directors as it will to investors. Up to now, most directors have never seen a tally for total pay they've promised to executives. "Pay is all compartmentalized. Boards would approve salary, a certain amount for a bonus, or a certain amount if he got a raise, but no one ever added it all up," says Fred C. Ilesley, the head of consultants Compensation Venture Group.

With proxy season approaching, boards are finding themselves going deep into compensation consultant reports and questioning the details of these packages even sometimes, in board meetings, CEOs and other paid officers for their backs. Compensation lawyer Melbin says the story of a major company several months ago, which he sat down on a board and then outlined his concerns. The CEO had a provision in his contract that

A Bigger Voice for Small Investors

BY ROBEN FARZAD

The very rich, F. Scott Fitzgerald once observed, “are different from you and me.” That has applied even to shareholder activism, a niche of the investing world dominated by hedge fund managers who are paid enormous fees to flatter and claw for every last nickel of return on behalf of their wealthy clients.

But with corporations under mounting pressure to acknowledge shareholder rights, ordinary mutual fund managers are increasingly asserting themselves on behalf of smaller investors.

The standout example is David J. Winters, chief executive of Mountain Lakes, N.J.-based Wintergreen Advisers, a mutual fund firm with \$1.3 billion in assets under management. His 15-month-old Wintergreen Fund returned 20% in 2006, far points more than the Standard & Poor’s 500-stock index, thanks in good part to his activist approach. “We don’t treat our stocks like rental cars,” says Winters. “You’ve got to think and act like an owner, getting the company to think better.” That’s what Winters has been doing with his second-largest position, Consolidated-Tenaska Land Co. The 105-year-old property developer owns a vast expanse of virgin land in Florida. Winters has been using his 16% stake to encourage management to stay the course on its measured development

campaign and to buffer it from pressure to liquidate its acreage. “We try to engage companies in a long-term constructive way,” says Winters. “They’ve been very receptive.”

Meanwhile, Franklin Mutual Advisers, Winters’ old fund shop, has affixed itself to the ankle of forest products giant Weyerhaeuser Co. Franklin is using its

\$1.2 billion stake to petition the company to convert itself into a real estate investment trust in order to gain tax advantages.

Even Wall Street, which takes great pains not to offend investment banking clients, is flexing its muscle to benefit fund investors. Morgan Stanley Investment Management is using its 7.6% stake in The New York Times Co. to lobby Times management for more shareholder accountability. In December the \$450 billion asset manager—whose funds are widely available to retail investors—hired a respected activism expert to deal exclusively with corporate-governance issues.

So-called socially responsible investing is also exerting more activist influence. The asset management arms of Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley, and UBS are all signatories to the 2006 Carbon Disclosure Project, a global effort to push companies to recognize their impact on climate change. The roster of more than 200 supporting investment firms, representing \$31 trillion in assets, is emboldening a slew of socially responsible proposals at shareholder meetings. “We’re seeing a strong increase in the support for our proposals,” says Stu Dalheim, manager of advocacy and policy for Calvert Group, the \$14 billion socially responsible fund shop. He says the company’s environmental and social resolutions at corporations are now “routinely getting support in the 20%-to-30% range,” three times what it was five years ago.



required the company to reimburse for his medical coverage, deductibles, and copays but it also had to give him a “gross-up” for the payments. One of the stunned board members said: “Now let me say this straight—not only do you not have to pay the amounts for your medical coverage that every other employee of this company has to pay, we pay your taxes on it.” The CEO turned bright red, Melange says, recognizing how badly that was going to look on the disclosure forms. He quickly agreed to give up the perk.

Elsewhere, too, such goodies are disappearing—but not without a price. In a recent filing with the Securities & Exchange Commission, the board of Lockheed Martin Corp. said it would eliminate executive perks—including fees for country clubs, a car and driver, and

tickets to sports events—in return for onetime salary adjustments. Lockheed’s directors had no comment. But getting executives to actually notch down their pay isn’t so easy. On the really big-ticket items directors have little leverage to alter the terms of employment contracts.

It’s not just compensation committee members who find the world changing. Audit committees used to meet only twice a year: once when it was time to take the audit in and once more to ratify it. Dick Swanson, chair of the audit committees of two NASDAQ-traded companies, says he now holds 8 to 12 meetings a year for each committee. In addition, he spends many more hours keeping up on what all the other board committees are doing, especially focusing on any risk—financial, operational, or otherwise—that the company

may run. “It’s not like the old days when you could join a board for the twice-a-year dinners,” says Swanson.

Some argue that as a result of the heightened pressure, boards are getting better. “One of the reasons bad stuff went on so much in the past,” says Warren L. Batts, former chairman and CEO of Tupperware Brands Corp. and now a director of Methode Electronics Inc., “was the board wasn’t organized to deal with them. People would look around at each other and say, ‘Who’s going to be the first to say something here? I don’t think I want to.’” Now, better-educated and maybe a little scared, more directors are speaking up. ■

BusinessWeek.com For a Q&A on corporate governance with tech legend Jim Clark go to www.businessweek.com/extras.



LISTEN
For Jobs,
a bravura
San Francisco
presentation

HELLO, WORLD

TURNING CELL PHONES ON THEIR EAR

Is the new iPhone a genre-buster in the mold of the Mac and iPod? Yes—and no

BY PETER BURROWS
AND ROGER O. CROCKETT

HIS USUAL SMOOTH voice turned raspy, Steve Jobs nonetheless radiated the satisfied glow of a man who had just pulled off a bravura performance before a packed house at San Francisco's Moscone Center. In his hand was his latest gem: a combination phone/music player/Web browsing device called the iPhone. Tapping on its sleek, candy-bar-size screen, Jobs conjured up Wall Street's verdict: "Let's see, Apple's stock is up...8%!" he said matter-of-factly. "Now let's look at RIM [cell-phone rival and BlackBerry maker Research in Motion]. Hmm, it's down 7%."

Look out—here comes another genre-

busting gadget from Jobs and the newly named Apple Inc. Despite the iPhone's high starting price of \$499, Jobs is promising to turn the cell-phone business on its ear. That's no idle threat, coming from the guy who paved over the personal computer's awkward interface of arcane commands with easy-to-use graphic icons in the 1980s. Apple also set the tone for the digital music market when it brought out the iPod in 2001, sweeping away a clutter of clunky, hard-to-use players.

DROP THE 'COMPUTER'

NOW, JOBS AIMS to leapfrog rivals with a device that offers a similar panoply of capabilities to other high-end "smart phones" like the BlackBerry and Palm's Treo—minus the frustrating complexity that has turned away mainstream consumers. "The problem is that they're not

so smart, and they're not so easy to use," Jobs told the adoring Macworld crowd. Here's why the iPhone should scare daylight out of phone makers: Despite Apple's announcement that it was dropping "Computer" from its name, the iPhone is more computer in the iPhone than about any other smart phone out there. It runs a slimmed-down version of Mac OS X software found in every PC. And it's a lot easier for Apple to port phone features to a mobile computer than it is for a handset maker to move features the other way. If the iPod helped people carry all their music with them anywhere, the iPhone promises to cut the moorings of a whole new swath of digital activity, from e-mail to video entertainment. "It clearly underlines the fact that we're entering a new phase of computing," says Seamus McAteer, co-founder of the market research firm M:Metrics Inc. "Mobile phones are becoming full citizens in the computer world."

The iPhone could set a new standard for the universal digital device that goes on sale in June. An ingenious interface lets the phone play many roles. Gone is the keyboard, the usual mess of tiny keys and cryptic buttons, replaced by a touch-sensitive 3.5-inch screen.

But if the iPhone is to be truly revolutionary, it must also crack open the power structure of the cellular industry. That will be a much tougher nut. Today, most consumers choose a carrier, then pick from various phones that are compatible with its network. Apple created the online music infrastructure in an environment where the established market had been disrupted by file sharing (remember Napster?). But the wireless phone industry is completely different, with strong incumbents. And unless Apple drops the price, the iPhone may not appeal to enough buyers to seriously disrupt the industry. There's also the little issue of whether Apple can wrest the iPhone away from Cisco Systems Inc.

Still, Apple's rethinking of the phone may spur the whole industry to do the same on its many visions of an easy-to-use universal digital device. This has been



Gone
tiny!
Instead
a touch-
sensitive
screen



Conventional wisdom would tell you small farms can't operate as efficiently as large ones. But in Poland, Cargill is going beyond the conventional to help small livestock farmers compete. Large farms in Europe have traditionally had the advantage of feed delivery services. For small producers must travel to dealers to buy the few bags they require. So Cargill worked with feed dealers to bring the store to the farm, on trucks that efficiently deliver small feed orders on a regular schedule. The dealers get new customers and farmers get service they never thought possible. This is how Cargill works with customers.

collaborate > create > succeed™



HOW DO YOU EFFICIENTLY DELIVER
FEED TO A FARMER WHO KNOWS
ALL HIS ANIMALS BY NAME?



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ongoing struggle for Motorola Inc., even while it was scoring a major hit with its slick-looking RAZR. CEO Edward J. Zander is now pushing simplicity. His new RIZR Z6 model, due out midyear, will let users download a song, send photos, or leap to the Web in a click or two, down from about six with current phones. "Wouldn't it be great to have an easy-to-use, same-as-your-PC mobile device in your pocket?" Zander asked an audience

at the Consumer Electronics Show in Las Vegas on Jan. 8.

Sure—but it sounds like the iPhone. If it really catches fire and Cingular Wireless, Apple's exclusive U.S. partner, benefits from the relationship, other carriers may have to rethink their strategy. Instead of pushing their mobile services such as movies and music, they might let handset makers and content partners control more applications that lead to

greater data usage. The iPhone's bilities also could help spur Cingular sales of other services, from photoing to basic three-way calling.

It's still six months before Jobs' est brainstorm hits stores. But all it is delivering the phone industry wake-up call. ■

—With Cliff Edwards and Steve Wildstrom in Las Vegas, and Arik F. dahl in New York

LEXICON

TALK OF THE TECH TOWN

BY STEPHEN H. WILDSTROM, CLIFF EDWARDS, AND JAY GREENE

When **Steve Jobs** took the wraps off Apple's new iPhone at the Macworld Expo in San Francisco, he instantly upstaged an even bigger technology event in Las Vegas. More than 140,000 dedicated gearheads mobbed the hotel showrooms at the Consumer

Electronics Show to ogle a bewildering array of gadgets. These have a variety of exotic capabilities and their own geeky names. So memorize this list before you try talking with haughty store clerks.

BusinessWeek weekend See the latest gadgets from the Consumer Electronics Show on our weekly TV show, *BusinessWeek Weekend*. Check listings or go to businessweekweekend.com

Full HD (aka 1080p)

Currently the best image quality you can get on high-definition television. But content is scarce.

Follow-me TV

Lets you start watching a recorded TV show in your family room, say, and then move to your bedroom without losing your place.

Blu-ray Disc, HD-DVD

Two rival standards for next-generation, high-definition DVDs—it's still too early to call the winner.

HDMI

A mysterious standard for connecting an HDTV source such as a cable set-top box, to an HD display. The mystery: How a cable can cost \$80 to \$120.

Slingbox

A device from Sling Media that makes live or recorded TV from your home system available to PCs and handhelds over the Net.

HSDPA/EV-DO

Two superfast third-generation mobile networks, the former from Cingular Wireless, the latter from Sprint Nextel and Verizon Wireless.

Location-based services

Global positioning chips in your phone let companies figure out where you are and point you to the best local shop or restaurant.

WiMAX

A new mobile Internet standard, more advanced than Wi-Fi, that will soon be available from Sprint Nextel, Clearwire, and others.

IPTV

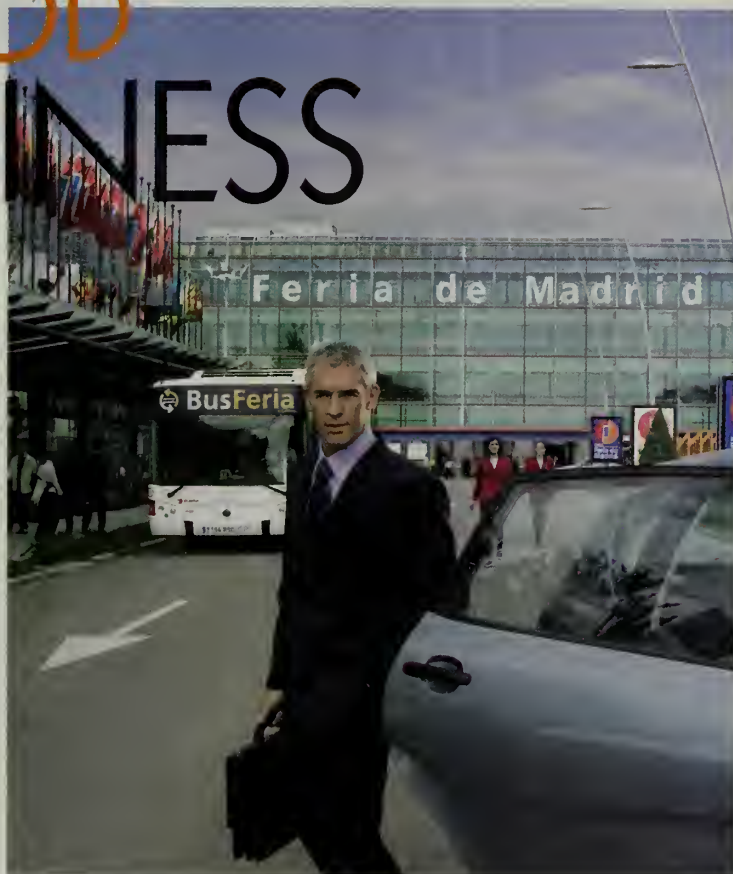
Stands for Internet protocol television—meaning TV delivered over the Web.

Home servers

Put all your photos, music, and video on one server that can dish them up on different devices in your home.



NEW GOOD BUSINESS



TRADE FAIRS ORGANISED BY IFEMA

JANUARY

INTERNATIONAL GIFT, JEWELLERY AND FASHION
JEWELLERY WEEK
INTERGIFT ... ufi
IBERJOYA ... ufi
BISUTEX ... ufi

FEBRUARY

SIMM Madrid International Fashion Fair ... ufi
CIBELES FASHION SHOW
CASA PASARELA Design Fair for Home Trends

MARCH

SAL Food Trade Show
SIPIEL. FOOTWEAR AND LEATHER GOODS
INTERNATIONAL WEEK
MODACALZADO ... ufi
IBERPIEL MARROQUINERÍA ... ufi

APRIL

MADRID INTERNATIONAL FURNITURE EXHIBITION

MAY

MADRID INTERNATIONAL AUTO SHOW
DIVERSE SELECT PRODUCTS

AUGUST

PROMOGIFT Promotional Gift Trade Fair

SEPTEMBER

SIMM Madrid International Fashion Fair ... ufi
CIBELES FASHION SHOW
INTERNATIONAL GIFT, JEWELLERY AND FASHION
JEWELLERY WEEK
INTERGIFT ... ufi
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OCTOBER

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REAL ESTATE

NEW LISTING! (SORT OF)

Agents are pulling houses off the market and then presenting them as new offerings

BY PETER COY

REAL ESTATE AGENT ROSS Simone wasn't attracting any potential buyers for a house in Mechanicsville, Md., that had sat on the market for months, so last November he took action. He pulled the house out of the regional database of active listings and then immediately reinserted it, changing the property ID number used to track properties over time. The result: The house appeared to be hitting the market for the first time. "It's in the best interests of my client [the seller]," Simone said in a November interview. "I started doing it consistently this year. I do it as much as I can."

With open houses as quiet as death

lately in many parts of the country, sellers' agents are trying everything they can to make a sale, including sometimes tweaking the computerized data that potential buyers depend on. Fresh listings attract attention and can fetch higher prices because buyers are less likely to make lowball offers.

Real estate is largely self-regulated. In most of the U.S., agents are responsible for entering information about the homes they're selling into a database that is maintained by the local Multiple Listing Service. Each of the 900-plus MLSs sets its own rules. The trick of making old listings appear new is against the rules of Simone's MLS, although he said later that he didn't know it at the time.

What's perhaps more surprising that in some regions, the local MLS has nothing to prohibit relisting a house a way that makes it appear new on market. In Atlanta, for example, Multiple Listing Service Inc. charges agents just \$25 to withdraw a listing. When they then relist the home, it shows up on "hot sheets" of homes that are fresh on the market. A buyer's agent investigates can see that the house was for sale before, but not for how long. MLS President Cantey Davis acknowledges that the system could give buyers a wrong impression of how long a house has been for sale but says he has received a "minuscule" number of complaints about it.

KNOWING WHAT TO LOOK FOR

WHEN MANY HOMES in an area are listed as new, it skews the "average on market" statistic, making the market look healthier than it really is. For agents, refreshing a listing can also disguise the fact that the previous listing was at a higher price. Buyers often regard a price cut as a sign of weakness.

Whether it's within the local rules or not, the practice of relisting houses to give them a new debut is a symptom of an imbalance in market knowledge. Buyers can sometimes spot manipulation of the databases, but you have to know what to look for, and many buyers' agents don't.

Is this wrong? Many MLS organizations think so. In Massachusetts, the Property Information Network Inc. recently improved disclosure of sales histories. Metropolitan Regional Information Systems Inc., which covers Mechanicsville, Md., says it checks its listings nightly for falsifications. In fact, it says it eventually caught and corrected Simone's gambit, which

first pointed out by the Southern Maryland Housing Bubble News blog. (Simone's boss, Wayne Wivel, president of Re/Max 100 in Annapolis, Md., said December he had no knowledge of the manipulation.)

But brokers often resist change. Northwest Multiple Listing Service in Kirkland, Wash., discloses the history of listings but relists still show up on the hot sheets, CEO Jack Johnson says. "We've had difficulty convincing the board of directors to eliminate what he calls 'cancel/relist.' As long as the buying public knows more about properties than the agents who are selling them, caveat emptor. ■



Resetting the Odometer

Here's how some real estate agents can manipulate computerized listings to obscure how long homes have been for sale:

WITHDRAW a house, then immediately relist it to reset "days on market" to zero

ZERO OUT the property ID number, which can track the history of listings

TWEAK the address so the system can't see that a house has been listed before

Hitachi | true stories

COAL'S COMEBACK

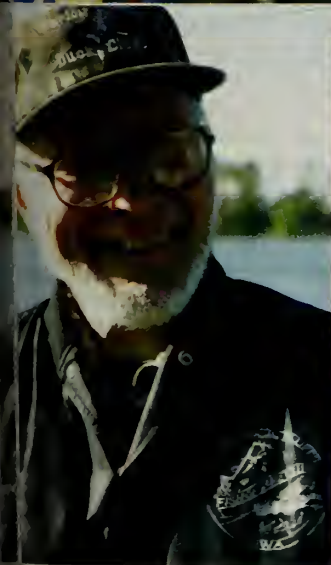
True Story of Clean Power in Council Bluffs



Coal used to be a four-letter word in environmental circles. But supercritical coal-fired technology from Hitachi is helping change that perception, starting with MidAmerican Energy Company's Council Bluffs Energy Center Unit 4.

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JOB-HUNTING

WHAT B-SCHOOLERS LUST FOR NOW

These days, private equity is the No. 1 object of desire. But jobs are scarce

BY MICHELLE CONLIN

EVERY DECADE, ANOTHER faddish career opportunity dazzles the nation's business schools. In the 1980s, MBAs dreamed of Wall Street fortunes, swaggering their way into penthouses and private planes. During the dot-com bubble, it was about vesting swiftly and starting a foundation by age 30.

Today job lust among B-schoolers is fiercest for the gilded, clubby preserve of private equity. "Absolutely, it's become the hot job for MBAs," says Maury Hanigan, president of New York's *MBA Scouting Report*.

As always, MBAs chase the money. And nowhere are the pay packages more regal than in the land of private equity. First-year compensation of \$300,000 for top-tier talent at a Wall Street investment bank doesn't seem too shabby—until you consider that thoroughbred MBAs joining the largest private equity shops command base salaries and bonuses as high as \$450,000. Add to that, of course, the real payoff: the equity. "More equity is flowing downstream to these new hires," says Brian Korb, a partner at New York executive search firm Glocap Search, co-publisher of the *2007 Private Equity Compensation Report*. "Especially for the all-stars. It's just like in sports."

There's just one hitch: There aren't as many private equity jobs out there as you might think. While many of the biggest funds will hire about 20% more B-school

grads this year, says Korb, demand for such jobs outstrips supply by a factor of about five to one. And the positions typically go to those with prior experience. A taste of just how cloistered this world is: The mighty Carlyle Group sent co-founder David M. Rubenstein (BW—Jan. 15) to Harvard Business School in October to woo finance stars over dinner at a gourmet restaurant. But Carlyle's 50% jump in hiring? It amounted to a mere seven spots, says human resources manager Annie Paydar.

You wouldn't pick up on the exclusivity by visiting a B-school campus, though. From the Wharton School to the University of Chicago's Graduate School of Business, it sometimes seems as if private equity is all anyone is talking and thinking about. MBA programs have always had private equity clubs. But B-schools at New York University, Dartmouth, and Columbia all report record memberships in these networking fests. At Wharton, nearly half the student body is a member of the private equity club. Conferences starring such legends as Blackstone Group chief Stephen A. Schwarzman sell out months in advance. And the schools have been falling all over themselves to add classes teaching everything from innovative dealmaking to the art of wielding "influence" within a firm.

With jobs tight and

INVITING BIGWIGS

Wharton students organize a Private Equity Conference

standards high, students are scrambling to prove themselves at the private equity altar. Many of Troy Barratt's buddies at Columbia Business School are already

set with sweet deals at consulting and investment banks. But when they go down to New York City's meatpacking district to swig Grey Goose and dancing, "I wave goodbye and tell them to have a good time," says Barratt, president of Columbia's Private Equity Venture Capital Club. He stays behind to set up coffee dates and e-mail contacts.

At Dartmouth's Tuck School of Business, six students were so desperate to snag private equity work that they spent the winter on surfing vacations over winter to fly to Mumbai, India, where they formed free labor for private equity firms looking for research. While their students knocked on doors and clapped receptionists in the hope of getting in front of some private equity and fund partners. "You have to find innovative ways to differentiate yourself," one of the students, Shelly Rastogi.

Some see this as a leading indicator of yet another bubble. We know the earlier stampedes to Wall Street and Silicon Valley ended. In five years, these junior barons want to start their own funds, will the wash of money be in private equity? Then again, is there a better school for a lesson in risk?

—With Jena McGregor in New York



THE STAT

\$450

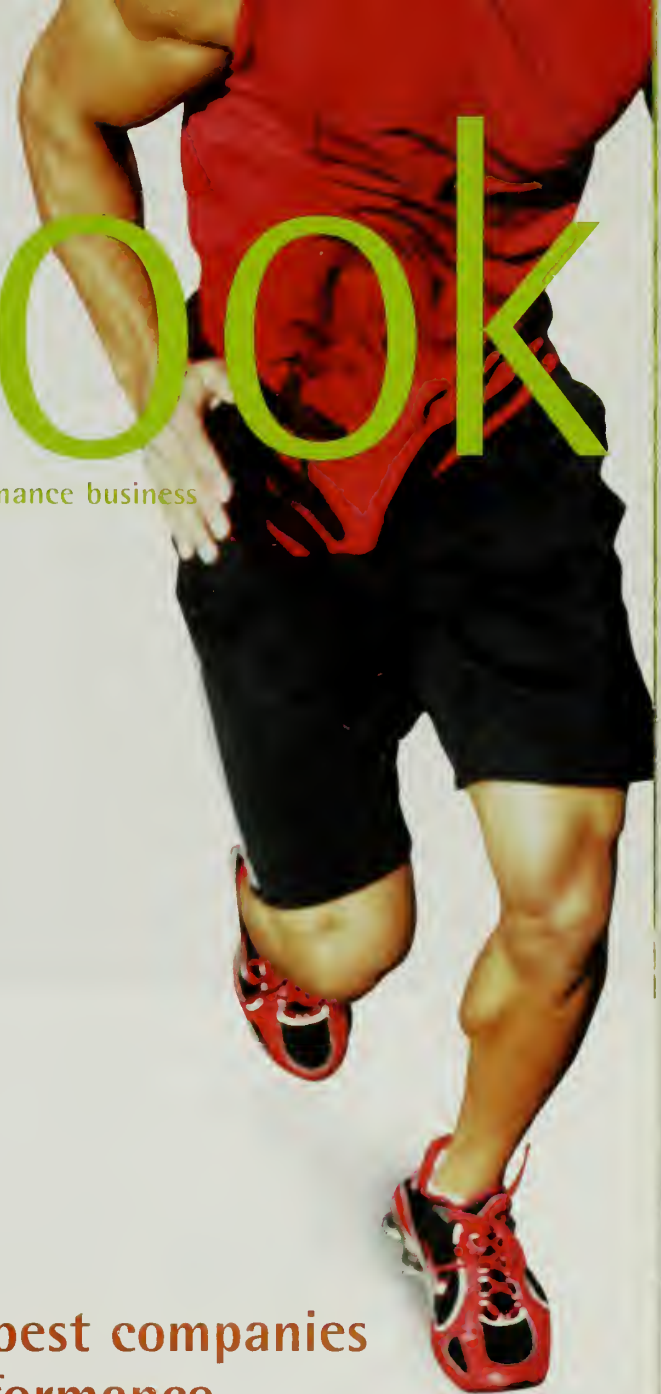
THOUSAND

First-year compensation for top-flight talent at a big private equity shop (before equity), vs. \$300,000 at an investment bank.

Data: Glocap Search

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Outlook



A special excerpt from the journal of high-performance business

>
accenture

High performance. Delivered.

Going the distance

**How the world's best companies
achieve high performance**

After three years of original research, industry analysis and rigorous testing, Accenture has developed a compelling set of practical insights for companies that aspire to uncommon business success.

What does high performance mean, and how can organizations increase their chances of achieving it?

These have been the driving questions behind an ongoing Accenture program of original research that is now entering its fourth year. The program—which to date has included analysis of 6,000-plus companies, from which we identified more than 500 high performers—has been important not only in terms of our ability to help clients achieve success but also in the context of the larger marketplace of ideas: A 2005 *Harvard Business Review* survey recognized Accenture's High Performance Business research as one of the 10 most notable initiatives in the field during the past quarter century.

Several recent and well-known attempts to define business success have used criteria that, on closer inspection, begin to look suspiciously like popularity contests. We were determined to set forth a course of research based on data and metrics, not just reputation. Accordingly, the definition of “high performance” that we arrived at and tested was the enduring or sustained out-performance of peers, across business and economic cycles, often across generations of leadership, measured by widely accepted financial metrics.

High standard

This distinctive definition sets a very high standard. Many companies appear to be high performers in the short run, but decline quickly when business conditions turn against them. To be a true high performer, on the other hand, a company must thrive across economic and market disruptions. And high performance must be determined not by the use of a single measure but of a specific set of measures. To this end, we analyzed performance over five key dimensions: growth, profitability, positioning for the future, longevity and consistency.



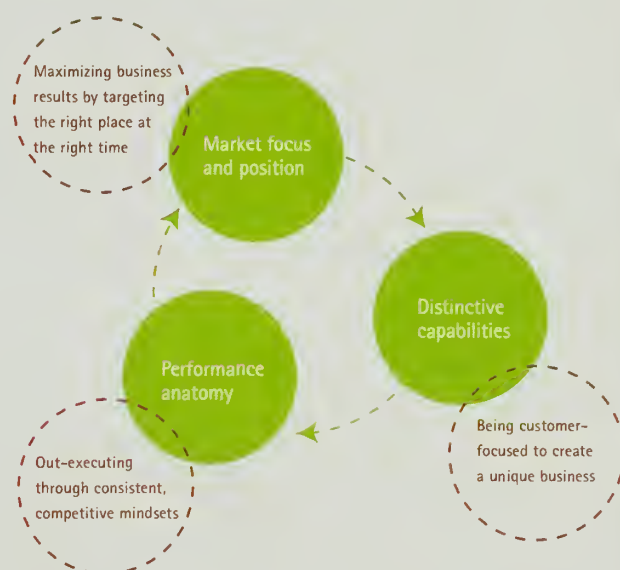
After analyzing the performance of leading companies, we were able to identify the common features of high performance—the attributes of excellence that all high performers display, regardless of industry. We called this common ground “competitive essence,” which, in turn, is comprised of three building blocks of high performance:

Market focus and position. High-performance businesses have remarkable clarity about where and how to compete. They always find where the market action is hottest. And when one market matures, high performers are ready with the next big thing.

Distinctive capabilities. High performers have a unique ability to build and connect capabilities in a way that drives significant value creation. They successfully translate big ideas regarding customer needs into a unique set of connected business processes and resources that cost-effectively satisfy those needs.

Performance anatomy. Organizational culture is a vital component of business success. It is also a concept that has been notoriously difficult to pin down. We have brought more specificity to this concept by developing

To achieve high performance, organizations need to get three things right.



Advertisement

an explanatory framework we call "performance anatomy." This framework defines the essential mindsets that lead to the behaviors that determine how—and how well—an organization approaches tasks that are critical to business success.

The three building blocks have provided an essential means of organizing our insights about high performance. Subsequent industry and functional research has continuously enriched our understanding of the nature of these components.

Consider our research into how companies in various industries achieve the right market focus and position. For example, our study of health care providers found that to improve their performance, these organizations need to think differently about the markets they serve. One way this sector's high performers have distinguished themselves has been by recognizing and exploiting growth opportunities in preventive health care and health maintenance. Analyzing high performance in this industry reinforced our judgment that being agile and having a view of multiple strategic horizons are key elements in achieving the most effective market focus and position.

Functional analyses of high performance

Along a track parallel to the industry analyses, Accenture's global service lines took up the challenge of understanding the contribution that capability mastery in key functional areas makes to achieving high performance. (Our service lines consist of professionals organized internally along functional lines, including Strategy, Supply Chain Management, Human Performance, Customer Relationship Management and Finance & Performance Management, as well as cross-functional groups such as Information Technology.)

The central insight from these studies is that each high performer masters a highly select set of business processes and resources that we define as a "distinctive capability." Unparalleled excellence in this set of functions constitutes a unique business formula for achieving competitive advantage. Lower performers, on the other hand, fail to achieve this mastery across a range of functions that is the price of admission to even above-average performance.

The next stage of the journey

In the next stage of our research, we will shine light on the paths organizations can and should take to arrive at high performance. We have already begun exploring how companies come to recognize the triggers of transformation—how they become committed to achieving high performance, how they set their course toward it and how they traverse one of the many possible paths to that destination.

To this end, we have embarked on a much deeper mining of our database of peer-set metrics. We also recently completed a cross-industry analysis of high-performance businesses versus their less successful competitors, uncovering several misconceptions about the nature of high performance and a number of reasons why every company can and should strive to become a high-performance business.

We began this journey three years ago with the stated belief that high-performance businesses are not simply born—they can be made. Our research has only deepened this conviction, as we have uncovered the evidence that companies can, through sheer force of will, propel themselves along the paths to high performance. We remain committed to identifying both the "what" and the "how" of high-performance business.

This article was excerpted from *Outlook*, the Accenture journal of high-performance business, and is part of a larger body of work—nearly 50 articles—published over the past three years. To read this and other *Outlook* articles on high performance in full, and to review the findings of our High Performance Business research, please visit accenture.com/research-articles

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High performance. Delivered.

NAME AND FORTUNE

IT'S ALL DONALD, ALL THE TIME

For the self-described "hottest brand on the planet," life is a nonstop media event

DIANE BRADY

DONALD TRUMP IS ABOUT to give me an exclusive look at his finances, but the phone is ringing off the hook. This time, it's a TV producer: "Is this the most handsome, the richest, the most charismatic man in New York?" He's trying to book Trump for his show. But Trump is fresh from *The Price Is Right*, *The O'Reilly Factor*, *Access Hollywood*, *Larry King Live*. He's booked to go on David Letterman. And there's a woman downstairs in the lobby of Trump Tower waiting to get a \$10,000 check Trump offered her after he jumped the subway tracks two days earlier to save her life. The producer is begging. "I've got to get back to my real job," says Trump with mock exasperation. He's clearly flattered.

Forget *The Apprentice*, which launched its sixth season on NBC on Jan. 7. The real entertainment right now is the Donald Trump show. The real estate mogul is going on everybody from the talk show host Oprah Winfrey to author Michael O'Brien. He feels invulnerable, maligned. The comic charge: that America's richest famous billionaire is so good with money. O'Brien snickered on TV when he had gone bankrupt. He hasn't, although his publishing company did. And Trump is suing O'Brien for libel, in his 2005 book,

Trump Nation, three unnamed sources have pegged his net worth at as low as \$15 million. "I lost deals because of this," complains Trump. O'Brien's lawyer says the suit is without merit. The actual worth of his largely private

Trump seems wistful at the prospect of the Rosie feud fading



empire is, of course, hard to pin down. *Forbes* estimates it at \$2.9 billion. Trump has his chief financial officer, Allen Weisselberg, show me documents that put his net worth at roughly \$4.1 billion as of June, 2006, with assets totaling \$4.8 billion and liabilities of around \$700 million. That includes a valuation of \$370 million for Trump Tower which has a \$25 million mortgage—"and that's because there's no prepayment clause!"—as well as \$900 million for "club facilities and related real estate" such as 75 residential lots along the Palos Verdes Peninsula near Los Angeles. Then there's

the value of his name, which Trump calls "the hottest brand on the planet." It's not Coca-Cola, but who else gets equity stakes in prime properties for putting up their name and little else?

Why this is the stuff of lawsuits is another question. By most sane assessments, Trump is rich. When he puts his name on bottled water, vodka, or a business suit, it sells. Trump buildings get a premium. People clamor to hear his speeches, for which he gets as much as \$1.5 million a pop. They buy his books. They even still watch his reality TV show, with 9.1 million viewers tuning into the Jan. 7 premiere.

The truth is that Trump likes combat, especially when it's played out in public. He's suing the town of Palm Beach, Fla., for \$25 million, with the money earmarked for "returning Iraqi vets" if he wins, because of the town's alleged harassment when it tried to get him to take down an 80-foot flag pole at his private club, Mar-A-Lago. "In life, you have fighters and nonfighters. You have winners and losers," says Trump. "I am both a fighter and a winner."

If fame could be converted to currency, few would doubt Trump's riches. And his media star has risen since his press conference last month to announce that he was letting Miss USA Tara Conner keep her title, despite her hard-partying ways. (Trump co-owns the pageant.) He even seems wistful at the prospect of his public riff with the prickly O'Donnell fading into silence.

But there's work to do. Before subway hero Wesley Autrey comes to accept his check, Vice-President Rhona Graff asks Trump if he wants the media entourage surrounding Autrey to be allowed in, too. Is she kidding? "Bring them all in!" says Trump. Autrey's 6-year-old daughter comes over and sits on Trump's lap. "Would you like to help me run my business?" Trump asks. Cameras are clicking. The whole family gets in with Trump, and then he sits alone, striking a determined pose against the Manhattan skyline. Autrey and the gang of reporters leave. "That guy is amazing," says Trump. The media moment is complete. "And what did it take? Five minutes?" Now, that's \$10,000 well spent. ■

PETROLEUM

BP FEELS THE HEAT

2006 was a horror, and problems remain. Will John Browne leave early?

BY STANLEY REED

EXECUTIVES AT BP'S HEAD-quarters on London's leafy St. James's Square are marking their calendars with grim resignation. In mid-January, a panel led by former U.S. Secretary of State James A. Baker III is due to release a long-awaited report on a series of mishaps at the energy giant. The study could further bruise BP's already battered reputation and might hasten the departure of CEO John Browne, until recently one of Britain's most celebrated corporate chieftains.

If the findings are as harsh as some BP insiders fear, it will probably refocus attention on Browne. In 11 years as CEO, he has transformed BP from a mid-dling player into an intensely competitive money machine. Browne consummated five big deals in five years, including the \$62 billion takeover of Amoco in 1998 and a \$32 billion buyout of Arco in 2000. But in his quest to boost financial returns, Browne may have overlooked problems for which he has paid dearly. In 2005, a refinery accident in Texas City, Tex., killed 15 people, sparking a firestorm of lawsuits. Last June, U.S. regulators alleged that BP manipulated the propane gas market. Then in August, BP was forced to cut production in Alaska's Prudhoe Bay field after inspectors discovered corroded and leaking pipelines.

The Baker report is likely to criticize top management for being lulled into complacency. While safety statistics showed improvement, the report is expected to say not enough was done to

ensure correct procedures were followed. Browne might not disagree. "We learned a lot from what happened at Texas City," he says. "We are redoubling our efforts in safety processes."

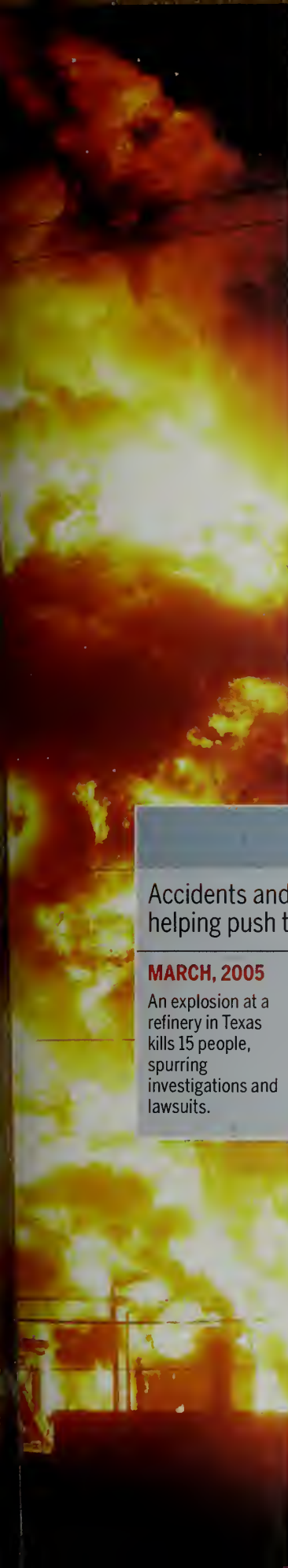
The Baker panel, however, isn't Browne & Co.'s only upcoming worry. The U.S. Chemical Safety & Hazard Investigation Board (CSHIB), a federal agency that oversees refineries, has also been looking into the Texas City explosion and is expected to release its findings in March. As the inquiry has progressed, CSHIB Chairman Carolyn W. Merritt has emerged as one of the British giant's harshest critics. Among the shortcomings contributing to the Texas explosion, according to Merritt: failure to assess the impact of cost pressures on safety, and blindness to growing risks at the plant, which had already experienced three fatalities in 2004.

Merritt further faults BP for not learning the lessons of refinery accidents at Grangemouth, Scotland, in 2000. Following those incidents, BP was fined and criticized by the Scottish authorities for poor safety management, including inadequate maintenance. In its drive to increase production and slash costs, Merritt says, BP's leadership failed to communicate the importance of prudent work practices. "You can't assume that everyone understands



TEXAS CITY
Some charge Browne (above) overlooked safety risks

DWIGHT C. ANDREWS/TEXAS CITY SUN/AP PHOTO; (INSET) THE DAILY TELEGRAPH



that safety comes first," says Merritt. She says she was so shocked by the lapses her investigators were turning up that she recommended that BP finance an independent investigation into safety and maintenance practices, which led to the creation of the Baker panel.

Executives privately say that problems were allowed to fester in a few of the less glamorous corners of the BP empire. Industry insiders say this may be partly due to Browne's view of the oil industry as a kind of three-dimensional chess game against rivals, particularly Shell and Exxon. "He has a restlessness; he is only interested in new ground," a close associate once said. Refining clearly didn't fall into the category of "new ground." It tends to be a low-margin business, and BP's focus has been keeping a lid on costs. BP executives say they recognized that the Texas refinery needed fixing, but the company did too little too late.

BP also commissioned its own study shortly after the Texas incident, which could hardly be called glowing. The 176-page report revealed a demoralized workforce that didn't follow the rules and where "safety knowledge and skills within management and the workforce were generally poor." The report identifies

tions. One source says Browne may have been guilty of "naivete" in trusting that managers in Texas and Alaska could achieve his demanding financial goals without compromising operations.

Some put it more bluntly. BP "is a financial culture gone wild," says Bernard Picchi, an analyst at Wall Street Access in New York. "The company has been doing deals for the sake of doing deals with an almost maniacal focus on the bottom line, to the [detriment] of normal operating standards." BP shares traded on the London Stock Exchange are down about 17% in the past year—making it one of the worst performers among major European companies. BP's recent travails have stripped "the management premium out of the stock, which takes years to build up," says Jonathan Wright, an analyst at Citigroup in London. Brokerage Morgan Stanley forecasts that BP will earn \$21.1 billion in net income in 2006, a 7% decline from 2005.

TRICKY TASK

THE QUESTION NOW is whether Browne will stick around until his scheduled retirement at the end of 2008. For several months, the board has been mulling possible successors. The leading candidate is Tony Hayward, who heads up exploration and production, BP's most important businesses. But he could be hurt by recent disappointments such as BP's estimate on Jan. 9 that its fourth-quarter 2006 production would fall by 5%. Another possibility is Robert Dudley, CEO of TNK-BP, a joint venture in Russia that accounts for about 25% of BP's production. Dudley has pulled off

the tricky task of pleasing both top management and BP's Russian oligarch partners without running afoul of the Kremlin. As an American and an alumnus of Amoco, Dudley could also help bolster the company's U.S. credentials.

No matter who gets the nod, BP's continuing turmoil has sent a wake-up call to the company. The "mantra of more-for-less holds that we can get 100% of the task completed with 90% of the resources," Hayward said in a speech to employees in December. "But it needs to be deployed with great judgment and wisdom. Otherwise you run into trouble." ■

BP's Trail of Woe

Accidents and investigations have shaken investor confidence, helping push the giant's shares down by 17% in the past year:

MARCH, 2005

An explosion at a refinery in Texas kills 15 people, spurring investigations and lawsuits.

JUNE, 2006

U.S. regulators say BP manipulates propane prices. Other inquiries target its oil and gasoline trading.

AUGUST, 2006

Production is halved at BP's Prudhoe Bay oil fields in Alaska after pipeline corrosion and a spill.

JANUARY, 2007

Worries over potentially harsh findings by Baker's panel depress company morale.

numerous problem areas that could be tied to cost-cutting measures, including poor training and failure to replace a crucial safety device that was outmoded and "potentially hazardous."

Yet Browne's intense drive for results combined with BP's entrepreneurial culture may have also played a role in the company's woes. While Browne puts his managers through tough, detailed reviews each quarter, BP is less of a command-and-control company than rivals. It operates with a decentralized structure designed to reward individual initiative, and managers are expected to use their own judgment in running their opera-



CARS

EVEN TOYOTA ISN'T PERFECT

A raft of recalls lately has it scrambling to safeguard its reputation for quality

BY IAN ROWLEY

TOYOTA WAS BUILT ON details. After decades of study and refinement, the company has developed thousands of pages of guidelines that lay out exactly what needs to be done at every step of the automaking process. That attention to the nitty-gritty has helped create an industrial machine that's unparalleled in building problem-free cars and trucks.

But growing numbers of flaws have started to tarnish Toyota Motor Corp.'s reputation for quality. Since 2004 the automaker has had to recall 9.3 million vehicles in the U.S. and Japan—its two biggest markets—up from 2.5 million in the previous three years. The problems got so bad that, in July, Toyota CEO Katsuaki Watanabe felt obliged to bow deeply in apology.

Given Toyota's obsession with details, it's no surprise that it would ask someone who knows how to focus on the small stuff to fix the problem. In June, Toyota

ordered former Europe chief Shinichi Sasaki back to Japan to help get a grip on the issue. The 36-year Toyota veteran has spent three decades working to ensure glitch-free production. Although Toyota has long had a quality chief, Sasaki is the first person to do the job full-time. "My responsibility is to tell all Toyota employees the quality aspect of their jobs," says Sasaki.

Toyota chieftains say the company is making progress. In December, Executive Vice-President Masatami Takimoto said that when it comes to recalls, "the worst is now over." And Watanabe, while again apologizing for recent faults in vehicles, said Toyota is "right on track in ensuring good quality."

Sasaki's task is made more difficult by Toyota's rapid growth. In recent

FINAL INSPECTION

At the Tundra pickup assembly line in San Antonio

years, the company has opened at least two overseas plants; ally, and this

it's poised to overtake General Motors Corp. as the world's No. 1 carmaker. Toyota makes nearly as many vehicles outside Japan as it does at home, meaning a cadre of Japanese engineers is no longer big enough to train all the new workers at foreign plants. To make up for the deficit, Toyota last year opened new "Global Production Centers" in Kentucky, England, and Thailand. These facilities, much like the one established in Japan three years ago, teach trainees the Toyota way in such as welding and painting.

GARAGE REPORTS

ANOTHER NEW INITIATIVE: better record-keeping. In years past, Toyota maintained repair data only on vehicles under warranty, which meant it missed glitches that popped up later on. Now, Toyota shops in Japan provide a full report on repairs to cars of any age. The company's chief is also asking suppliers to share information and use common parts. In Japan, Aishin Seiki, and others have just started using one design for voltage stabilizers in electronics in Toyota's cars.

More important is designing safety into cars in the first place. To give drivers extra time to get things right, Toyota has tapped the brakes on the introduction of new models. For instance, the next generation of Corollas, already on the drawing boards in Japan, has been held back for a year in the U.S. to ensure that American workers have the time to learn how to build a model without glitches.

There's clearly room for improvement. In July, the company recalled

THE STAT

9.3
MILLION

Toyota's recalls in the U.S. and Japan since 2004, up from 2.5 million in the previous three years.

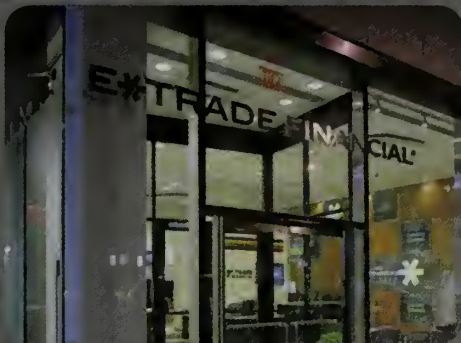
Data: Toyota, National Highway Traffic Safety Administration

157,000 Tundra pickups because the trucks' front-seat anchor child safety seats—structure required in a vehicle that has a switch to turn off air bags. (If deployed, air bags can kill children riding in the front seat.) Toyota seems, simply put, about the anchors of designing the truck the kind of oversight Sasaki vows to stop before any recalls need to be sent. "Every decision at this stage," he says, "is done properly."

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GLOBALIZATION

OUTSOURCING HEADS TO THE OUTSKIRTS

GramIT brings tech-services jobs to rural areas—and transforms villagers' lives

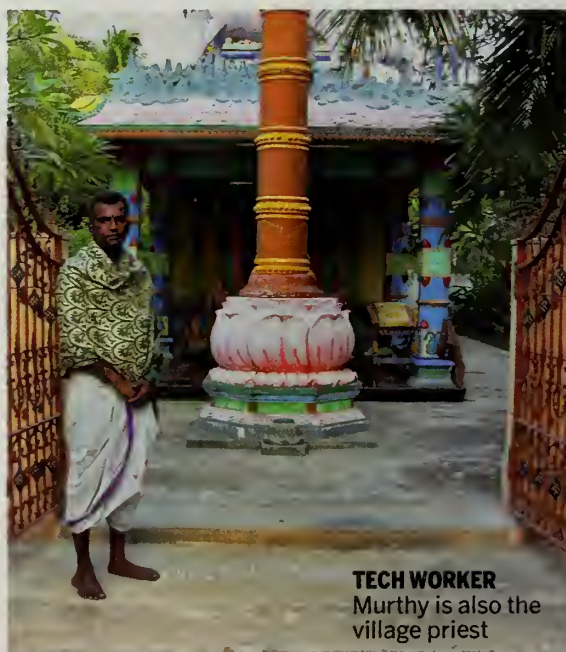
BY STEVE HAMM

THE VILLAGE OF ETHAKOTA in India's Andhra Pradesh state hardly looks like a place that has been transformed by the Information Revolution. To get there, you take a 10-hour train ride from Hyderabad, the nearest big city, then drive an hour on narrow roads past rice paddies, coconut groves, and ponds teeming with prawns and crabs. The village itself is a collection of simple brick houses and thatch-roof huts. Yet in a tidy office shaded by 30-foot-tall palms, 50 young people sit at PCs connected to the Internet via a long-distance radio link, doing business process outsourcing (BPO) tasks such as checking expense account receipts for Indian corporations and arranging job interviews for applicants in distant cities.

They're working for GramIT, a 16-month-old nonprofit that's seeking to transplant India's tech services boom to some of the country's 600,000 villages. Workers in Ethakota earn a fraction of what the outsourcing troops in Bangalore do, but they're not complaining. Srinivas Ruddireddy makes twice as much money arranging car services online for people in Hyderabad as he does from the two-acre rice plot he tends in the early morning. He now plans to send his 4-year-old son to private school. "My lifestyle has entirely changed," says the 30-year-old. "But I'm able to stay in the village."

So far, GramIT operates in three villages in Andhra Pradesh. But the group hopes soon to expand to many more. "If work can shift from the U.S. to a city in India, why can't work

The fledgling nonprofit is proving itself one community at a time



TECH WORKER
Murthy is also the village priest

from cities in India shift to villages in India?" says Ramalinga Raju, chairman of tech services provider Satyam Computer Services Ltd. and founder of the Byrraju Foundation. He set up the group in 2001 to fund projects, such as GramIT (*gram* is the Sanskrit word for "village"), aimed at transforming the rural economy.

Taking outsourcing to the countryside makes sense. About 70% of India's 1.1 billion citizens—most of them subsistence farmers who barely scrape by—live in villages. Moving service jobs to rural areas provides work for the unemployed and could slow migration to the crowded cities. Entry-level GramIT employees, all with at least three-year college degrees, earn

\$800 a year, compared with \$2,000 to \$5,000 annually for an employee at an urban outsourcing shop. And because there are few other good jobs in these communities, GramIT's centers see a 5% annual turnover—dramatically lower than the 60% rate in places such as Bangalore.

SCALABILITY

SATYAM HAS SIGNED on as the organization's biggest customer and says the organization does good work. Hoping to cut back-office costs in half, the company has farmed out human resources and accounting jobs to GramIT; now it is reviewing other processes it might

move off. Although the villagers speak little more than English, it's sufficient for the jobs they're doing. Surya Gadiraju, vice president for technical development in Satyam's e-services operation. "It took just a couple of weeks to get up to speed and quality," he says.

The concept isn't an easy sell. "It would be hard to achieve international standards for service and to scale up the operations" of village outfits, says Azim Premji, chairman of India's Wipro Ltd., which has 15,000 workers scattered across India. That's why GramIT is starting small and focusing initially on the Indian government and domestic

corporate clients. "There's a fair amount of skepticism about the abilities of villagers to provide quality service," says J.K. Manivannan, the Byrraju partner in charge of GramIT. "But show it can be done, others will follow." He has already gotten nibbles of interest from some global corporations.

GramIT is clearly having a profound effect on Ethakota. One beneficiary is K.V.S. Murthy, who was forced to leave home to find work a few years ago. Now he's back in the village and working for GramIT. The income from his outsourcing job has allowed the 32-year-old to take up a revered but low-paying job in the community that has been passed down from generation to generation: his family's—priest. Murthy's good fortune would surely ensure GramIT's success, but you've got to admit the karma is good. ■

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Special Report

Outsmarting



he Market

Behind Barclays' quest to build a world-class team of academic quants that systematically does the impossible. **By Anthony Bianco**

IT WAS NO GREAT SURPRISE that Richard G. Sloan took a sabbatical from his tenured position at the University of Michigan's Ross School of Business last summer to join an investment firm. Wall Street has stepped up its hiring of academics in recent years, and the 42-year-old Sloan is one of accounting's bona fide stars. But Sloan's explanation of why he left academia for Barclays Global Investors (BGI) is startling. "I just felt that BGI was getting ahead of me," he says. "I came here because this is where the leading edge in my area of research is now." Sloan is one of more than 100 PhDs in BGI's employ, Sloan creates a cadre of highly credentialed brainpower that covers diversity finance or economics department in the land of quantitative investing into an astounding recent spurt. BGI has added \$877 billion in funds since 2002, growing its assets under management to \$1.62 trillion and moving it above State Street, Fidelity, and Vanguard as the world's largest money manager. Sloan plays Global Investors' original claim to fame was invent-

ing the index fund, so it is fitting that the bulk of the wealth this prototypical "quant" shop manages—nearly \$1.1 trillion—is invested in vehicles that replicate the Standard & Poor's 500-Stock index and other indexes. However, Sloan and the other brainiacs at BGI continue to hire away from elite institutions around the world are not preoccupied with devising clever new ways to match market returns. Rather, they seek to do something that the efficient-market theories on which the firm was founded held to be impossible: to systematically beat the market.

Hard Data vs. Heroics

IN ITS OWN QUIETLY METHODICAL fashion, BGI has indeed topped many indexes with remarkable consistency by overweighting its investment in certain of their component securities—a conservative quant technique known as "tilting" or "enhancing." In fact, every one of BGI's 19 principal stock market tilt strategies has outpaced its benchmark over periods ranging from 4 to 20 years. Add the gains produced by more

aggressive vehicles such as hedge funds, and over the last five years BGI has generated a colossal \$19.9 billion above the market return—or “alpha,” in investment parlance—for the 2,800 pension funds and other institutional investors that are its clients.

Long dismissed on Wall Street as a think tank that runs money on the side, the firm and its eggheads have also engineered a tenfold rise in profits since 2001. BGI, a subsidiary of British bank Barclays PLC, is likely to take in more than \$1.6 billion in pre-tax profits this year, contributing to its parent company's much promoted allure as a takeover target. BGI, which began as the investment arm of Wells Fargo Bank, was acquired by Barclays in 1995 for \$443 million—a great bargain, as it has turned out.

“When we first started, we were a bunch of guys who stared at our shoes at cocktail parties,” says Richard C. Grinold, a former University of California at Berkeley finance professor who is BGI's senior research guru. “But now the rest of the world has to react to us.”

BGI's ascendance highlights the coming of age of quantitative investing, which seeks to purge money management of human fallibility through the rigorous application of the scientific method. “The goal is to replace heroic personalities contending in an atmosphere of greed and fear with compelling hypotheses subjected to hard data,” declared Grinold and longtime colleague Ronald N. Kahn in a recent manifesto.

Fine, but how exactly does Barclays go about outsmarting the markets on such a scale? To find out, *BusinessWeek* interviewed scores of BGI's alpha-seeking males and females, sat in on a brainstorming session of its Asian equities research group, and huddled with a portfolio manager on its trading desk as she put the firm's “portfolio optimizer” smoothly through its high-tech paces.

This deep look into the workings of the planet's largest quant shop abounds with informative lessons for the average investor. Unfortunately, though, they add up to this simple, humbling imperative: Get thee to an index fund. Now.

You and I can no more hope to do what BGI does than we can to rival such famously heroic stockpicking personalities as Warren Buffett and Peter Lynch. Quant investing BGI-style requires fluency in applied mathematics as well as access to the prodigious computing power needed to continuously crunch the numbers for 10,000 stocks and 2,500 debt issues and execute thousands of trades a day. With 2,640 employees spread among 11 offices around the



RECENT HIRES

The University of Michigan's Sloan and Wharton's Richardson are both on leave

world, BGI is the largest quant manager by a wide margin.

Much ink has been spilled over the rapid growth of funds and their increasingly aggressive alpha-seeking tactics. Meanwhile, a less publicized but equally telling shift is taking place at the opposite end of the risk-reward spectrum, the soaring popularity of exchange-traded funds (ETFs) breathing new life into indexing, BGI's original forte. In the U.S., ETF assets under management topped \$450 billion in 2005, up from \$102 billion in 2002. BGI dominates the ETF business with a 60% market share, according to Morgan Stanley.

The explosive emergence of both risk-intensive hedge funds and risk-averse ETFs can be explained by a single concept: transforming the big-money world of institutional investing: alpha-beta separation. The basic idea is to lock in a return (the beta part) on one end with low-cost index funds of one sort or another. On the other, pay up to put money in “alternative strategies” run by managers with a proven track record to beat the market (the alpha part).

A recent study by McKinsey & Co. found that by the end of 2005, the alpha and cheap beta part accounted for 50% of all institutional assets under management, doubling the figure in 2003. “The warning signs have already begun to toll for traditional firms not willing to part from their business-as-usual approach,” McKinsey noted. Investment management consultant Casey, & Associates concurs, predicting nearly half of the world's 50 largest money management firms “are going to be around in their present form for much longer.”

As the inventor of indexing, BGI has been separating alpha and beta since its founding. “The world has moved to BGI's way,” says John F. Casey, Quirk's chairman and a longtime

BGI's Bonanza

America's biggest money manager has added \$877 billion since 2002

ASSETS UNDER MANAGEMENT (IN BILLIONS)

	ACTIVELY MANAGED	INDEX*	OTHER	TOTAL
2000	\$124	\$628	\$51	\$803
2001	126	590	53	769
2002	129	578	39	746
2003	217	735	118	1070
2004	281	919	162	1362
2005	340	1006	138	1513
2006**	369	1057	197	1623

*Includes exchange-traded funds (ETFs)

**As of June 30

Data: Barclays Global Investors

One weak spot: The quants' rational method makes them vulnerable when irrational manias and panics sweep the markets

champion. "I don't think a lot of clients consciously decided that they wanted to shift to quants so much as they wanted to go with someone who knows exactly what risks they are taking and will do what they say they will do. And that's BGI."

In traditional circles, quant has been derided as "black box" investing for its reliance on computer models comprehensible only to the double-domes who created them. The black box survives today in the more mystifying form of investing techniques derived from fuzzy logic, neural networks, Markov chains, and other nonlinear probability models.

epitomized by BGI, though, modern quant investing is rooted in the same economic fundamentals that preoccupy stream analysts, though quants amass much more data and process it more systematically than anyone else does. A key difference is that quants ignore the story behind the numbers. The whole sprawling human drama of business is of no interest to Barclays researchers, who never venture out to visit a company or tour a store or a factory. If a thing cannot be measured and factored into an investment hypothesis for testing against historical data, BGI has no use for it.

Quants also are far more mindful of risk, as measured mainly by price volatility. Traditional portfolio managers tend to diversify risk by concentrating their investments in a relative handful of companies that they believe will beat the market over the long run. Instead of angling to get in early on the next Wal-Mart or Microsoft, BGI spreads its bets across the entire market swath, frequently trading in and out to exploit pricing anomalies. The firm's \$19.9 billion in alpha represents just 1.64% above the market return, on average.

Quant is no investing panacea, however. Historically, its practitioners have fared better in periods when value trumps growth and have tended to flounder at the fringes of the markets, where data tend to be spotty. Quant's by-the-book formalism and dependence on historical data also leave its devotees particularly vulnerable to the manias and panics that disrupt markets at irregular intervals. The classic example is Long-Term Capital Management, a fixed-income superstar that boasted two Nobel Prize winners on its board. Highly levered LTCM imploded in 1998 under losses of \$4.6 billion after the Russian government defaulted on a bond issue, disrupting credit markets worldwide.

It was another catastrophe—the pricking of the tech bubble in 2000—that marked the beginning of quant's rise. A trickle of new funds from safety-minded institutional investors grew into a torrent as BGI, LSV Asset Management, Enhanced Investment Technologies, AQR Capital Management, and other top quant firms posted stellar returns in the buoyant, value-tilted markets of recent years. Each of the three firms that sit atop the latest hedge-fund rankings is a quant master of long standing: Goldman Sachs, Bridgewater Associates, and D.E. Shaw. (BGI ranks fifth, with \$17 billion in hedge fund money.)

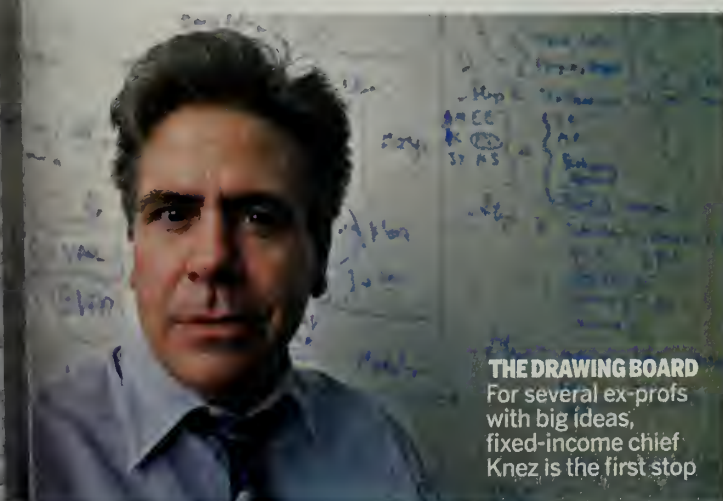
By contrast, the typical active money manager has struggled. Over the last five years the S&P 500-stock index has outperformed 71% of large-cap funds, the S&P MidCap 400 has topped 83.6% of mid-cap funds, and the S&P SmallCap 600 has bested 80.5% of small-cap funds, according to Standard & Poor's, a unit of The McGraw-Hill Companies, which also owns *BusinessWeek*.

Student Union Chic

BGI GOES TO GREAT LENGTHS to limit its exposure to human error by using computer technology to automate every investment process it can, including trading. And yet the ambiance at BGI's headquarters, in an office tower a block south of Market Street in downtown San Francisco, is much more coffee-stained grad school seminar room than antiseptic computer lab. For if the only investment ideas that count at BGI are those that can be expressed in software code, they usually begin as a flash of insight in the mind of someone like Xiaowei Li, one of BGI's 140 research officers.

Nov. 17, 2006, saw a milestone in Li's nascent career as an alpha hunter: her first presentation to BGI's Asia equities research group. The China-born Li brought impeccable credentials to the task, including degrees from Princeton University (a master's in economics and public policy) and Stanford University (a PhD in economics).

Li is the leader of a project analyzing non-Japanese Asian banks. The object is to identify statistical factors—or "signals," in quant speak—to help BGI determine which of the many banks traded



THE DRAWING BOARD
For several ex-profs with big ideas, fixed-income chief Knez is the first stop

in Hong Kong, South Korea, Indonesia, India, and other countries are undervalued in the stock market and which are overvalued. A signal highlights a market inefficiency; good ones are rare and often prove a juicy source of alpha.

Li, who had just returned from a swing through southeast Asia that included stops in Hong Kong and Macao, began her presentation by passing around a list of 25 potential signals. Li's ideas were sketchily annotated, but that was to be expected at this early stage. The meeting was just an inaugural brainstorming session, not a PhD thesis defense.

Gathered around a table in a small conference room on the 28th floor of BGI headquarters were a half-dozen of Li's peers, plus her manager and the co-heads of the overall Asian research effort, Ernie Chow and Jonathan Howe, both of whom joined BGI in 1999 and were the fortysomething graybeards of the group. Everyone in the room had either a PhD or a master's degree in financial engineering. The disciplines represented included physics, applied mathematics, and operations research, as well as finance and economics.

Li stood throughout most of the two-hour meeting, the better to scrawl phrases and formulas on the floor-to-ceiling whiteboard behind her. The discussion was highly technical and surprisingly lively. Who knew pre-provision operating expenses could be such a hoot? Chow and Howe took the lead in questioning Li, raising their voices only to talk over subordinates who on occasion were a bit overeager to comment.

Li held her own throughout, demonstrating impressive command of Asian banking arcana even as she acknowledged the limits of her knowledge, and smilingly accepted suggestions for further research. Afterward, Howe described the session as "pretty productive," even though the group hadn't even made it halfway through Li's list.

Li's bank study is one of a dozen projects in Asian equities alone. At any given time, 50 to 60 more alpha quests are in the works across BGI's other research areas: U.S. and European equities, fixed income, and global macro, which handles cross-border investing, currencies, and commodities. In 2006, Barclays spent \$120 million—10% of its total budget—on research. In the scale of its commitment to commercial innova-

of which are refinements of existing strategies rather than brand new, market-thumping ideas. The global macro group came up with a notable example of the latter by devising a set of signals that can pinpoint the timing of an economy's pivot from recession to expansion. By buying a country's stocks and shorting its bonds before its recovery was generally recognized, BGI's Global Ascent fund was able to generate total alpha of 4% in 2005 and 2006. To date, BGI has used this strategy in 15 countries and plans to apply it to perhaps 10 more.

BGI's researchers seek inspiration indiscriminately. "We will beg, borrow, or steal ideas from wherever we can," says Kenneth F. Kroner, a 12-year veteran who heads BGI's global macro area. "Richard [Grinold] likes to say that we have no pride whatsoever."

BGI has a line or two into every top research university and makes determined use of its connections to get the most promising academic research before it starts to circulate. Every BGI brings in a couple dozen leading scholars to present latest work in the sort of disputatious seminars that are a staple of campus life. Professors are generally flattered by attention and open to remunerative arrangements, including paid consulting gigs. Of course, the best way to prop up an academic's leading-edge insights is to pay his salary.

Richard Sloan's hiring was the culmination of an 11-year relationship with BGI. He was an unknown assistant professor at the Wharton School when he made his breakthrough discovery of the so-called accruals anomaly in the early 1990s. The immediate implications of Sloan's findings were so momentous

they were generally presumed to be erroneous. The young professor was unable to persuade an academic journal to publish his findings until 1996, about a year after BGI invited him to San Francisco for a private seminar. "BGI was the first place to really pay me for my work," Sloan says.

What he found was that the stock market is slow to differentiate between good old cash flow and noncash accruals as changes in reserves for inventory levels and bad debt provisions. Buying stocks of companies with the highest-quality earnings and shorting those most dependent on accruals, an investor could lock in 12% alpha. Analytical refinements noted in a second paper that was presented first at BGI in 2000 (and published in 2005) boosted the excess return to a gaudy 20%.

Sloan's assertion that BGI now sets the pace in early quality research annoys many academics in the field. It includes Russell J. Lundholm, who chairs the accounting curriculum at the University of Michigan at Ann Arbor's Ross School of Business, from which Sloan is on leave. "I can't believe the cutting edge is at BGI or any other firm," says Lundholm. He still jogs with Sloan when he's in town.

Of course, Lundholm doesn't know exactly what BGI is

BGI uses its connections at top universities to get a look at promising academic research before it starts to circulate

tion through research and development, BGI is the Bell Labs of high finance.

"What's really distinctive about BGI is the research effort. They throw a lot of resources at getting the best people and the best systems they can," says David F. Deutsch, chief investment officer at the San Diego County Employees Retirement Assn., a BGI client that ranks as one of the U.S.'s top-performing public pension funds. "What they do has to work, and it also has to speak to guys like me, who think about this stuff but who are not in the trading pits every day."

Like other quants, BGI regards its investment signals as trade secrets and guards them accordingly. Here, the traditional academic imperative of publish or perish has been turned on its head: If you publish (or otherwise spill the beans), you will perish.

BGI comes up with scores of new signals every year, most





se not even Sloan was allowed a glimpse inside the firm's "bucket" until he became an employee. Inside he found specific signals, including "a bunch of things that were new," Sloan says. Even as individual signals have come and earnings quality has been BGI's single richest source of over the last decade.

of Sloan's closest academic colleagues, fellow Aussie Richardson, joined BGI about the same time. Richardson leave from Wharton, where he is an assistant professor counting, to be BGI's director of U.S. credit research. In st weeks there, he compiled a long list of highly specific ch ideas for his boss, fixed income chief Peter J. Knez. he are just things I see because I'm coming in from the e and am closer to current academic research," he says. Whatever a new idea's provenance, as a rule, BGI will not it portfolio-worthy unless it first passes four tests. In peak, they are collectively known as SPCA, for Sensible, ictive, Consistent, and Additive.

start, a researcher must construct a hypothesis that basic economic sense. For Xiaowei Li, this means con- ing her list into a one-page "sensibility document" capable suading the firm to authorize the expense of empirical g. Evidence must be assembled showing that the signal tely outperformed in the past but that it can predict future market returns. The opportunity to realize these re- n must be consistently available, even in volatile markets. a, the idea cannot be an old notion repackaged to seem ut must add insight that is truly fresh.

Surprisingly, it is the initial criterion—sensibility—that is t to meet, with 40% to 50% of proposals failing to make gde. "The key is the S factor," says Kahn, who has a PhD physics from Harvard. "It's so easy to be fooled by the data b mistaking patterns in the data for a sensible hypothesis." Sponsors of proposals authorized for testing usually spend onths sifting data and assembling a so-called SPCA re- 20 to 25 pages. It is reviewed both by a group of senior e h colleagues and a third-party referee. About a third of reed proposals are rejected.

BRAINSTORMING Li leads a project to see which non-Japanese Asian banks are overvalued or undervalued

quantdom, the question of whether alpha exists as a finite market commodity is a topic of debate. Unquestionably, though, the shift of vast sums into quant hands is making alpha more elusive. "The fact that there are more and more quants chasing the same sort of factors will shrink the alphas from those factors gradually," acknowledges Robert C. Jones, who runs Goldman's equity quant effort.

BGI's top executives seem acutely aware that galloping growth could undermine the rigor and integrity of the firm's investment methods. Having more than tripled assets under active management, to \$370 billion, over the past three years, BGI has closed many of its market-beating strategies to new investment, at least temporarily.

This doesn't mean, though, that Barclays is backing away from its pursuit of advantage through research. BGI's capital spending rose 30% in 2006 and "will only slacken if we run out of new ideas," says CEO Blake Grossman, who started at the firm in 1985 as a portfolio manager. "A half-dozen years ago, a couple of guys could make a difference. Now it takes dozens of people and terabytes of data to be competitive."

Recently, Duke University's David A. Hsieh, a leading hedge fund scholar, theorized that only \$30 billion in alpha is realizable annually from the \$30 trillion market value of all stock and bond markets worldwide. It was intended as a very rough estimate, but if BGI is extracting \$4 billion to \$5 billion a year, what chance do the rest of us have to top the averages?

Think of Barclays Global Investors as the Wall Street equivalent of one of those giant factory trawlers that have revolutionized commercial fishing. This super-quant methodically cruises global markets, sucking alpha from the depths while everyone else drifts about in rowboats, corks bobbing pathetically atop waters that are nearly fished out. ■

Once approved, a new signal is added to one or more of the computer models BGI uses to forecast returns (or expected alphas) for each of the 12,500 stocks and bonds it tracks. BGI portfolio managers turn such strategies into investment portfolios for clients by running its return forecasts through an "optimization engine" that takes into account numerous risk factors as well as trading costs and spits out a trade list in the form of an Excel spreadsheet. The whole process takes 10 minutes or less.

How much bigger can BGI get? The short answer: a whole lot—and therein lies the danger.

As the world's largest indexer, BGI appears unassailable on the beta side of the great divide that is transforming institutional investing. Remarkably, the firm's iShares brand has taken a growing share of the ETF business even as it has grown by leaps and bounds.

But if the index business is congenial to scale, the history of active management is littered with the corpses of firms that let their market-beating prowess attract more money than they could handle. Within

Sweet **REVENGE**

The power of retribution,
spite, and loathing in
the world of business

BY JENA McGREGOR





WHEN IT COMES TO LARRY ELLISON, TERRY Garnett does not mince words. "I do hold grudges," Garnett says. "Am I motivated by that? Absolutely." A former Oracle Corp. senior vice-president, Garnett spent the early 1990s traveling around the world with Ellison, Oracle's CEO. They hobnobbed with the likes of media moguls David Geffen and Barry Diller as the company tried to become a player in the interactive-TV business. Garnett and the software billionaire were so tight that Ellison even invited him and his wife to go along on a trip to Kyoto in 1994. That year marked the 1,200th anniversary of the founding of Japan's former imperial capital, a meaningful occasion for Ellison, a passionate Japanophile.

Together, he, Garnett, and four others made the pilgrimage along the cherry-blossom-lined Philosopher's Walk to the famed Ginkakuji Temple.

But what came next led to the bad blood that Garnett still tastes more than 12 years later. Within weeks of their return from Japan, Ellison summoned Garnett to his office. He scrapped the interactive-TV startup the two were planning and, Garnett claims, fired him without giving a clear reason. "It was pretty clinical," he recalls. "I tried to keep composed."

Feeling numb, Garnett returned to his office, not more than 30 feet away, and packed up. Afterward, he spent weeks trying to understand why he had been fired. Garnett later sued Ellison, accusing him of unfairly firing him, but then he dropped the claims. (Oracle officials declined to comment, but their reply to

Garnett's suit cites his "declining productivity.") Brimming with anger, Garnett made a vow to himself: "There will be a day of reckoning." Today he is acting CEO of Ingres Corp., a software upstart that's gunning to grab market share from Oracle.

Ask CEOs what drives them, and they'll talk about success, personal fulfillment—a few will even admit to be driven by the desire for money and power. But Garnett's professed appetite for payback is a motivation rarely leaked from executives' on-message lips. "It's one of the great undiscussables," says Kenneth N. Siegel, a Los Angeles psychologist and coach to senior executives. "Just as you don't talk about lust in the executive suite, you don't talk about revenge as a significant motivator for success. But it clearly is."

In our euphemism-laden, numbers-driven, "it's just business" corporate environment, it's easy to forget that the desire to get even is one of those primal human impulses that lurks behind executive behavior. Revenge is at least as old as the Bible ("Vengeance is mine," saith the Lord) and provided a plot line for many a Shakespearean tragedy, but it's also written into the script of many of the most memorable corporate dramas. And in today's hypercompetitive business world, as the spiraling rate of executive turnover leaves behind a trail of ousted managers and as leaders marred by recent corporate scandals try to restore their reputations, it's a subtext of many of the most dramatic recent business stories, too.

Exhibit A: The Hewlett-Packard Co. leak investigation. Yes, maverick board member and wealthy venture capitalist Tom Perkins did the world a service in alerting government officials

REVENGE is "one of the g

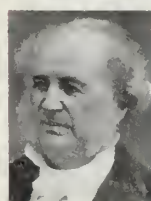
to the unsavory tactics being used by investigators hired by HP. But there's another way to look at this whole sordid s

Perkins, who would resign from the board, and Patricia Dunn, then its chairman, were embroiled in a bitter feud over board procedures. After the results of the leak probe, which angered Perkins' good friend, George A. "Jay" Keyworth II, were presented at a board meeting in May, Perkins accused Dunn of betraying him, violating an agreement they'd made to handle the leaker's identity "offline." (According to Dunn, there was no such arrangement.) He claimed that the reputation of a "good man"—his buddy Keyworth—was being "ruined," Dunn has said. After she stepped down as chairman in September, Perkins seemed to relish the moment. "My No. 1 thing was to get Pattie [Dunn] out as chairman, and I got that," he told *Newsweek*. "So I'm happy." Perkins, one might say, had gotten his revenge. (A rep for Perkins says he "acted solely in the best interests of HP, its shareholders and employees.")

'POETIC JUSTICE'

THE HP TALE ISN'T last year's only payback-tinged business drama. Kenneth G. Langone, the fiery billionaire co-founder of Home Depot Inc. and onetime head of the compensation committee of the New York Stock Exchange's board, was named

Corporate Revenge: A BRIEF HISTORY



Cornelius Vanderbilt (left) ushered in the age of American moguls, and his legendary ruthlessness set the bar for many titans to come. In 1853 the Commodore took his first vacation, an extended voyage to Europe aboard his yacht. When he returned to the U.S. months later, he found two of his associates had used the power of attorney he had left them and sold his interest in his steamship concern, Accessory Transit Co., to themselves. "Gentlemen," he wrote, in a classic battle cry, "you have undertaken to cheat me. I won't sue you, for the law is too slow. I'll ruin you." He converted his yacht to a passenger ship to compete with them, added other vessels, and started a new line, aptly named Opposition. Before long, he bought his way back in and regained control of the company.



Having a boss who calls himself "Merciless" after the *Flash Gordon* (above), should have been a warning. **Bernie Marcus** (far left) was still surprised when he was fired from Handy Dan Home Improvement. The boss was Sanford C. Sigoloff, of parent company Daylin Inc. With Marcus and another sacked Handy Dan employee, **Arthur Blank** (right), were develop-

own form of revenge: A warehouse-style home improvement store. In 1988, Home Depot had 96 stores and \$2 billion in sales.

Data: The Age of the Moguls, Stewart H. Holbrook. Built from scratch: Bernie Marcus and Arthur Blank with Bob Andelman, Jacocca. An Autobiography, Lee Jacocca with William Novak, news reports

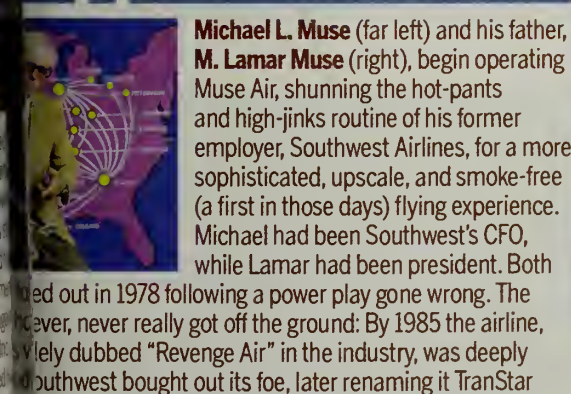
scussables" in business, says one psychologist

uit by former New York Attorney General Eliot Spitzer over
ole in ex-Big Board Chairman Richard Grasso's giant \$187.5
on pay package. In early 2006, during Spitzer's campaign
he Democratic gubernatorial nomination, Langone and
bers of his family gave \$64,000 to Spitzer's long-odds op-
nt, Tom Suozzi. He also urged friends and associates to do-
money. (In an e-mail, Langone said: "I thought it was time
and up to [Spitzer] and demand accountability. It wasn't
age, it was principle." His spokesperson says the funding
based "on the merits" of Suozzi's candidacy.)
nd following the government's indictments in May of class
n law firm Milberg Weiss Bershad & Schulman for alleged
al kickbacks to plaintiffs, some in Silicon Valley are savoring
wist of fate. While William Lerach, who aggressively sued
nology companies in the 1990s and left the firm in 2004, has
een named in the indictment, some executives still relish
rmer firm's misfortune. "We're all enjoying it because he's
asite," says T.J. Rodgers, CEO of Cypress Semiconductor
in San Jose. "It's just poetic justice."
dgers' glee has a name, of course: schadenfreude, or joy
ers' woes. It's a close cousin to the desire for revenge.
atisfaction we receive from the punishment of others is
nly something we can all identify with, but something
ich we're all neurologically inclined.

Ernst Fehr, a behavioral economist at the University of
Zurich, studies how our brains react when "social norms" are
violated. In Fehr's research, two players are asked to exchange
money according to various scenarios. When one player
hoards the cash for himself, the other has an opportunity to
punish him financially. The player who got burned is hooked
up to a brain scan while he's considering whether to retaliate.
Fehr found that the part of our brains associated with feeling
satisfaction was more strongly activated while players con-
templated getting even. "There is a hedonic force behind the
punishment," says Fehr. Put simply: Revenge is biologically,
scientifically sweet.

There's something delicious about getting back at someone
who has hurt us. Or doing well as that person looks on. Savor-
ing the balm of revenge does not require active stabs at retribu-
tion; it can also be a byproduct of success. "We hold the illu-
sion that if the other person is as venomous as we think, [even]
their knowledge of our success is psychologically damaging to
them," says Jeffrey A. Sonnenfeld, senior associate dean at the
Yale School of Management.

Spurned CEOs can experience this form of pleasure by
turning around a struggling competitor. Consider Millard
"Mickey" Drexler, the "merchant prince," as he has been
called for his pitch-perfect retailing skills, who was pushed



Michael L. Muse (far left) and his father, **M. Lamar Muse** (right), begin operating Muse Air, shunning the hot-pants and high-jinks routine of his former employer, Southwest Airlines, for a more sophisticated, upscale, and smoke-free (a first in those days) flying experience. Michael had been Southwest's CFO, while Lamar had been president. Both

ed out in 1978 following a power play gone wrong. The
ever, never really got off the ground: By 1985 the airline,
vly dubbed "Revenge Air" in the industry, was deeply
d Southwest bought out its foe, later renaming it TranStar



Lee Iacocca (above), who was ousted as president of Ford Motor Co. by Henry Ford II in 1978, publishes his autobiography, *Iacocca*. The 1984 book came at a delectable moment for Iacocca, who had gone on to take the helm of Chrysler just as it sank

into near-bankruptcy in 1979. Five years, a government bailout, and a hard-
fought turnaround effort later, Chrysler had paid back its government loans
and had a winner of an innovation in its minivan. Iacocca lambastes Henry
Ford II throughout the book. "Because of my pension, he still pays me a lot
of money to go to work every morning to see if I can knock his block off."

PHOTOGRAPHS BY (VANDERBILT AND YACHT) THE GRANGER COLLECTION, NEW YORK; (MING THE MARCELESS) UNIVERSAL PICTURES/PHOTOFEST; (MARCUS & BLANK) JONATHAN BURNETT; (MUSE AIR) AVIATION-IMAGES.COM; (MICHAEL & LAMAR MUSE) LES WOLLAM; (IACOCCA) BETTMANN/CORBIS

out of Gap Inc. in 2002 after 19 years at the helm. Unlike most other CEOs, who walk out the door with millions in severance, Drexler left behind a hefty package and its non-compete restrictions.

That decision allowed him to bag a job leading preppy retailer J. Crew Inc., which he helped private equity firm Texas Pacific Group take public in June. Since joining J. Crew, Drexler, 62, has hired at least two dozen executives away from his former employer. He has also launched a new brand called Madewell that, with prices below J. Crew's, could compete with Gap. Madewell's two stores, which opened in August, carry hip, high-quality jeans, sweaters, and accessories. Sound familiar? (One J. Crew representative says Madewell is not intended as a Gap competitor.)

Drexler has insisted he is not motivated by revenge, but he has also said that anger over his departure "helps fuel my accomplishment now." Even if payback isn't an active pursuit, he's probably savoring the redemption. J. Crew's initial public offering was one of the most successful in 2006. In its most recent quarter, operating income increased 51% from the year before. Meanwhile, his successor at Gap, Paul Pressler, is experiencing steady drops in sales and may be exploring a sale of the company. "[Drexler's] parting at Gap now in retrospect is probably deeply regretted," Evan S. Dobelle, a former Gap board member and now president of the New England Board of Higher Education, said in an e-mail. Drexler declined to comment to *BusinessWeek*.

THREATENED THRONE

REVENGE IS A RESPONSE to a perceived injustice or what psychologists call narcissistic injury, known to you and me as a wounded ego. This reaction is often acute in entrepreneurs or members of family businesses, whose sense of self-worth is bound to their businesses. "For a founder whose identity is wrapped up in his company, there's no end to the revenge that one could want to exact on those who threaten to take it away," says Kenneth Eisold, a New York psychoanalyst who counsels business executives.

In the case of an executive whose throne isn't just threatened, but taken away, nothing may be more fulfilling than being able to reclaim it. Steve Jobs, who was forced out of Apple Computer Inc. in 1985 only to return in 1997, isn't the only one who has achieved this unlikely feat. Take Malcolm Walker, a British entrepreneur who founded Iceland, a grocery chain specializing in frozen foods that's now among Britain's largest private companies. Back in December, 2000, when Iceland was

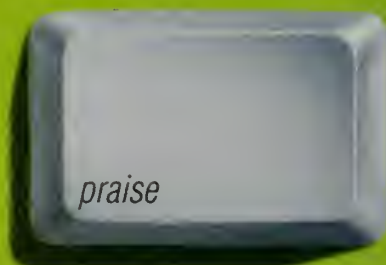
RESEARCH shows our bi

still a public company and Walker was looking forward to pending retirement, he controversially sold \$19.8 million of his equity stake just weeks before his successor, Bill Grieco, who took over on Jan. 2, 2001, issued a profit warning slumping sales. Shares went into a free fall.

It quickly became clear Walker had to resign immediately. Britain's Department of Trade & Industry (DTI), a government agency, launched a probe into the stock sale. "When I was no longer the guy who had built a successful business," says now. "I was remembered as the dodgy guy who was investigated for insider dealing." Later, Walker recalled: "It was a tremendous cloud hanging over me." Despite the dark



After a long battle, **Jeffrey Katzenberg** (left), ex-boss **Michael Eisner** (inset, above) called a "little midget," won about \$250 million in compensation. He argued he was owed after being fired from Disney in 1994. That year he started DreamWorks SKG, and went on to make *Shrek*, which grossed \$267 million at the box office and won a nomination for the Golden Palm at Cannes. Beyond the box-office bonanza, Katzenberg poked fun at Disney's saccharine fairy tales. While Katzenberg's accusation, some Hollywood observers viewed the movie as evil, perfectionist, and short **Lord Farquaad** (above)—as a par



ard centers light up when contemplating revenge

er didn't waste time before firing back. Within months, he ed a rival shop, which he joked would be called "Frozen ? (What was that again about retirement?) The store was ally named Cooltrader, and before long, Walker expanded outlets. Trapped on the sidelines of Iceland, he plotted his n. "I had something to prove," says Walker, who was later ed of any wrongdoing.

late 2004, Walker joined up with retail investment Baugur Group to buy back the grocery chain and, on 11, 2005, his birthday, returned to run his company. e he has busied himself with retrofitting stores and lifying inventories, he has also been settling a few old



Back in 1997, soon after **Steve Jobs** (left) returned to the company he started, **Michael Dell** (right) was asked at a technology conference what he would do about **Apple Computer**. "What would I do?" Dell joked to the gathered attendees. "I'd shut it down and give the money back to shareholders." Then in January of this year, just as inning what would turn out to be a tumultuous year, Apple's alization reached \$72.13 billion, surpassing Dell's. Jobs ail to his employees. "Team, it turned out that Michael Dell ct at predicting the future," he wrote. "Based on today's stock e, Apple is worth more than Dell."

scores. He renamed the years he was away the "Dark Ages" on Iceland's Web site, where he has cobbled together a list of Grimsey's turnaround forecasts in the press, mocking the oft-promised recovery. ("It's my Web site, isn't it?") He has sent a dossier of his own to the DTI, questioning Iceland's finances during his absence. (Grimsey told *BusinessWeek*: "I take no notice of Malcolm Walker. I've moved on with my life.") Today, according to Walker, Iceland's sales are growing again at double-digit rates. "Everything I'm telling you now enables me to feel totally vindicated."

High-profile departures or firings are hardly the only circumstances that can spur people to want to get even. From vendettas against co-workers who shoot down ideas to grudge matches between middle managers vying for a senior job, payback plays a role in the more mundane scenarios in corporate life, too.

Indeed, in business, revenge often takes on passive forms. "You rarely see someone with a knife in their back" in a business context, says Richard Olivier, an Englishman who runs workshops that use Shakespeare's plays to help leaders unravel motivations such as revenge, ambition, and power. Rather, "you see lots of people who are dying the death of a thousand small cuts," says Olivier, the son of actor Laurence Olivier.

Yet another business scenario that incites its share of retribution is the passed-over executive. "It's not as visible," says Yale's Sonnenfeld, "but there's a seething sense of resentment in people who've spent a lifetime thinking they've earned something only to have it snatched away at the 11th hour." Consider Joseph Galli Jr., who in 1999 was president of the power tools and accessories group at Black & Decker Corp. At 41, he was pushing his boss, CEO Nolan D. Archibald, who had been in the job for 15 years, to step down and give him his moment in the sun. When Archibald resisted, a frustrated Galli quit.

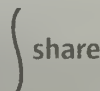
Those who know Galli say he is still driven by not getting the top job. His fondness for the tool business never waned, either: In his brief, one-year term as COO of Amazon.com Inc., he introduced tool sales to the online retailer before other categories, such as toys and office products, that most analysts said made more sense. And in 2001 he joined Newell Rubbermaid, drawn by the offer to be CEO and the chance to expand Newell's tool line into a force that could eventually challenge Black & Decker's market share. That never happened: In late 2005, after four years of unmet earnings targets, Galli resigned.

His newest post, as chief of Techtronic Industries Co.'s

PHOTOGRAPHS BY (SHREK) DREAMWORKS/EVERETT COLLECTION; (EISNER) KIN CHEUNG/REUTERS/CORBIS; (JOBS) JUSTIN SULLIVAN/GETTY IMAGES; (DELL) JACK PLUNKETT/AP PHOTO; (KATZENBERG) SOEREN STACHE/AP PHOTO

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global floor-care division, appears to be a stepping-stone to running the entire Hong-Kong-based company, which includes tool brands such as Ryobi. Galli, a fiercely competitive former college wrestler, is widely expected to be named CEO of Techtronic when his noncompete clause in the tool category ends in late 2007. "He is utterly driven by the thought of passing Black & Decker, so much so that he took a divisional job after being CEO of a whole company in order to line up the stars," says one former Techtronic executive. Galli, still bound by his noncompete, says he can't comment on the tool business.

Noncompete or nonsolicit arrangements, designed to prevent people from hiring former colleagues, can stand in the way of executives turning their revenge fantasies into reality. They may be barred from battling their former companies if they want severance pay. Still, recruiters say they often see spurned execs try to get around such agreements by using a headhunter, who would first conduct an exhaustive search, as a shield. Mark Jaffe, a Minneapolis search consultant, says clients can be pretty explicit with him, both when responding to rivals' poachings or when, as departed executives who become newly employed, they try to exact damage upon the company they've left behind. "This is not typically something that's very veiled [to the recruiter]," he says.

Indeed, says Brian M. Sullivan, CEO of New York search firm Christian & Timbers, some companies have offered premiums for recruiting people from a competitor that has stolen one of their own. "They'll put a bounty on them," he says. And when the poaching is personal, watch out. Jaffe says he recently got a request from the division president of a major company. She had just had one of her top people stolen away by a friend who worked at a rival. In filling the

Getting Even—Online

On the couch: A Video View with Kerry Sulkowicz, a psychoanalyst and author of *BusinessWeek's* "Analyze This" column.

The story behind the story: For a podcast interview with Management Editor Jena McGregor by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm.

Recovering from disaster: In a Q&A, Yale management professor Jeffrey A. Sonnenfeld discusses his new book, *Firing Back: How Great Leaders Rebound after Career Disasters*.

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now vacant job, Jaffe says, she urged him to focus heavily on the competitor. "Let's see how much damage we can do in filling that position," she told Jaffe, who nonetheless did find anyone at the firm.

Which brings us back to Garnett. Since getting sacked by Ellison, he has channeled his anger into investing in and launching up companies that compete head-to-head with Oracle and Ellison projects. The most recent of these is Ingres, a low-cost, open-source software startup that Garnett hopes will fill a hole in Oracle's high-price database business. Garnett targeted Ellison's team for several engineers and managers. He has also hired a small army of former Oracle folks to help him torpedo the old mother ship: Of Ingres' 250-member team, 50 are ex-Oracle, including several top executives and technologists. Many directors have the Oracle pedigree. "The simplest way to create a culture is to pick an enemy," says Garnett. "We have an enemy: It's Oracle." ■

—With Steve Hamm in New York and David Kiley in London

Grudges in the CUBICLE

The best-known vendettas may take place in the corner office, but the cubicle is no stranger to sabotage. Revenge in the workplace has been the research interest

of Georgetown University management professor Robert J. Bies since 1996, when he co-authored one of the first academic papers on the topic. Management Editor Jena McGregor spoke with Bies about why revenge is such a taboo subject in business and what managers can do to prevent destructive score-settling by employees.

What has surprised you in your research?

As I began, I would ask people: "Do you guys engage in revenge?" They'd say: "Oh no, we never engage in revenge." Then I would ask if they ever tried to get even with people, and they'd answer: "Oh, all the time." There's something about the word "revenge" that is very loaded. That's the hypocrisy of revenge in the corporate world. We say it doesn't exist, but it does.

How is revenge in the workplace different

from revenge in other parts of our lives?

In the workplace, there are some real power differentials that may not exist in other institutions. So much of your identity and who you are is invested in your job. There are so many different ways people can do harm to you.

Why do we have such a hard time talking about it?

For institutions, the desired imperative is control, standardization, routinization. My point is that [revenge] should be predictive because I can tell you what the triggers are that can make it happen. That's what our research is. We've outlined a series of events—layoffs without warning, public beratings, budget cuts without explanations—that can cause people to take revenge. It shouldn't be a surprise.

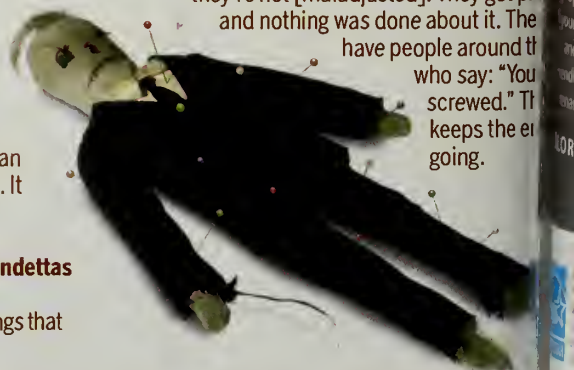
So, can managers control vendettas in the workplace?

We need to be aware of the things that

provoke it, but we also need to teach managers and leaders to treat people fairly. If you can train managers how to do that—give employees advance notice, provide explanations—it can mitigate the feelings of revenge.

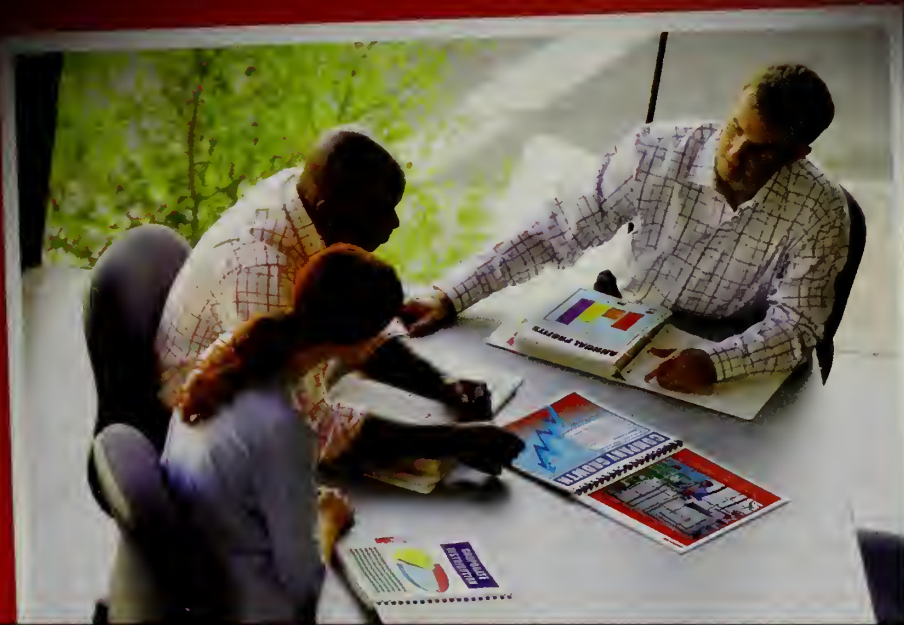
But isn't much workplace vengeance pathological? Isn't it being done by employees who think they've been wronged when really they haven't been?

Can there be people who are psychologically maladjusted who see a provocation that doesn't exist? Yes. But it's more common that they're not [maladjusted]: They got provoked and nothing was done about it. They have people around them who say: "You screwed." They keep the emotion going.



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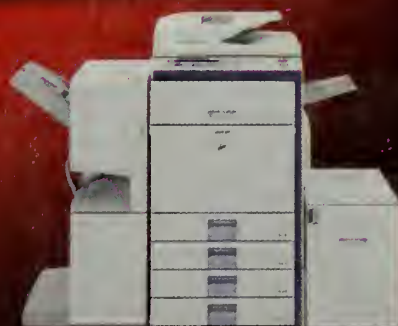


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Lobbyists Who Want Nothing

Why Big Sugar is refusing help from the Hill.
A collision course with candymakers

BY EAMON JAVERS

FOR MANY INDUSTRIES, IT'S red alert time in Washington. The Democrats now in control of Capitol Hill are making threatening noises about what they call overly cozy relationships between business and government. Companies in defense, oil, and pharmaceuticals are girding for legislative battle.

Then there's the sugar industry, historically second to none in winning protection from Washington. What is Big Sugar doing in this season of corporate anxiety in the nation's Capital? It's trying to reject a new federal subsidy. That's right: The sugar lobby has said "no thanks" to a proposal that would send hundreds of millions of dollars its way. And astoundingly, there's still pressure on Congress to give sugar producers the money they don't want. "It's a crazy system," says Sallie James, a trade analyst with the Cato Institute, a libertarian think tank in Washington. "It's what happens when politics interferes with the market."

DISCONTENTED CANDYMAKERS

THE ODD TALE of the corporate subsidy in search of a taker begins with the elaborate structure of other protections the \$10 billion-a-year sugar industry already enjoys. Since shortly after the Civil War, lawmakers from sugar-producing states have pushed the government to prop up the price of domestic sugar. The Agriculture Dept. limits the amount of domestically produced sugar that may be sold in the U.S. The government also discourages the importation of foreign sugar with quotas and tariffs. In addition, Washington operates a federal loan program that effectively sets a minimum price for sugar.

These arrangements benefit major producers such as U.S. Sugar Corp. and

Florida Crystals Co., as well as the marketer Domino Foods Inc. But American candy makers, soft drink manufacturers, and other large consumers of sugar have grown unhappy with the current system—and they're the ones pushing the subsidy Big Sugar doesn't want. The candy manufacturers and their allies complain that the restrictions and tariffs make U.S. sugar prices about twice as high as the world market price.

Seeking to lower the price of sugar that goes into chocolate bars, soft drinks, breakfast cereal, and other treats, manufacturers represented by the Sweetener Users Assn. are pushing Congress to make direct subsidy payments to grow-

ers. They're lobbying members of the Agriculture Committees in both the House and the Senate, and they say they're open to other ideas.

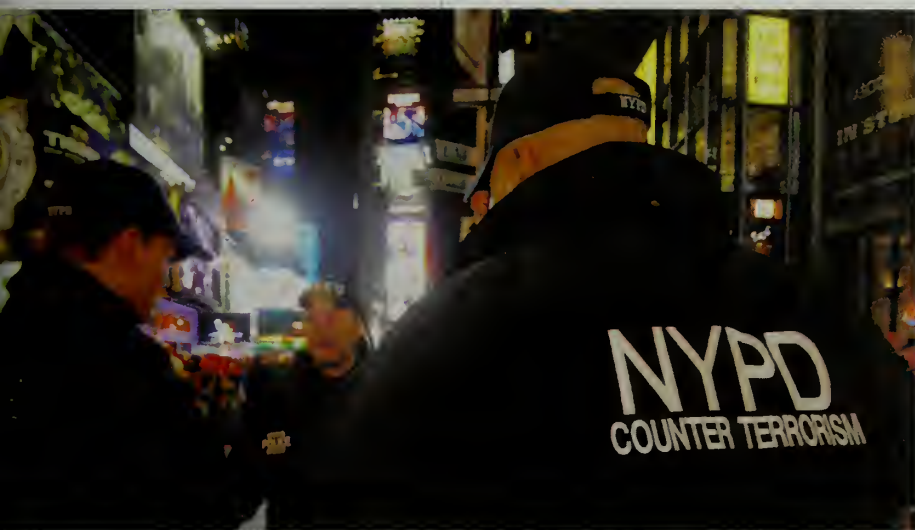
"We're looking for a program that doesn't have the government controlling the supply, but at the same time would help the government maintain farm incomes," says Susan Smith, spokeswoman for the National Confectioners Association, a trade group of major candy companies. For the big consumers, that's a compromise: For years they argued that sugar supports should be abolished entirely, but they were consistently defeated by the sugar lobby. Under this proposal, they would get lower prices and growers would keep their existing government support.

But a sugar subsidy program would cost money and worsen sugar producers' reputation for dependence on corporate welfare. The sugar producers argue a subsidy would shift the burden from consumers to taxpayers, at a cost of \$1 billion. That won't be politically popular. Worse, the subsidy could come to haunt sugar growers at the World Trade Organization if foreign producers object to it as an unfair advantage. "It's like the status quo," says Phillip H. Spokesman for the American Sugar Alliance, which represents growers. Representative Jeff Flake (R-Ariz.), generally opposes subsidies, put it bluntly: "They've got a good thing going now, so why chance it? They can eat their sweet cake and eat it, too."

The sugar industry may have money and the political muscle to things as they are. During the 2006 election cycle, they contributed \$2.7 million to congressional candidates; of that went to the newly empowered Democrats, according to the Center for Responsive Politics, a nonprofit research group in Washington. The sugaring companies contributed just \$800,000 to congressional candidates during the same cycle, but roughly half of their contributions went to now-of-power Republicans.

Sugar producers also have a key ally in Representative Collin C. Peterson (D-Minn.), who assumed control of the House Agriculture Committee last month. His Red River Valley district is packed with sugar beet farmers, and it's the single largest sugar-producing district in the country. Peterson he'll fight the proposed sugar subsidy and might even try to raise sugar prices, which, he says, "candy manufacturers really won't like." ■





NEW YEAR'S, NEW YORK Keeping watch in Times Square

Homeland Security 2.0

Five years after September 11, a new wave of smarter high-tech tools is coming to market

ARON PRESSMAN

IF ANY OF THE 68,000 rabid Philadelphia Eagles fans arriving for last Sunday's National Football League playoff game against the New York Giants knew that they had been scanned by the latest high-tech anti-terrorism tools, Pennsylvania security officials would have been pleased. Radiation probes at the gates of the Financial Field to stop terrorists sneaking in a homemade nuclear device that could kill thousands. Personal grounds carried even more equipment.

The new gear, made by Thermo Fisher Scientific Inc., was tailored to distinguish radioactive material from the harmless traces left by common medical procedures that have prompted screen questions more than a few innocent events such as the Super Bowl. Altham (Mass.) company's more sophisticated scanner and similar new products are part of a wave of advanced equipment coming to market after the September 11 terrorist

attacks. Call it homeland security 2.0.

After the 2001 attacks, federal, state, and local governments snapped up equipment that had been created for industrial applications such as detecting leaks at nuclear power plants. But the gear had been quickly adapted for its new use and didn't always perform as required. Portable detectors carried by some New York City policemen signaled an alarm near any radioactive source, even the granite around entrances to subway stations. Scanners for ports tagged containers carrying kitty litter as potential hazards. U.S. Customs & Border Protection, a division of the Homeland Security Dept., told Congress in May that it recorded 318,000 alarms from port sensors scanning 80 million containers over the past three years without finding any serious threats.

Thermo Fisher is aiming to eliminate the false alarms. "The govern-

ment rushed to buy systems that weren't optimized to detect the right thing," says Thermo's 49-year-old CEO, Marijn E. Dekkers. "We're working on better versions for a wave of reconstruction" that includes projects like installing next-generation scanners in major ports.

Dekkers, who closed an \$11 billion merger with Fisher Scientific in November, is looking for growth markets as he integrates the two companies' largely complementary product lines. Thermo is best known for lab gear such as mass spectrometers used in biotech research and detection equipment used by manufacturers and government security agencies. Fisher concentrates on test tubes, lab chemicals, and other basic items. Wall Street has given the merger a big vote of confidence: The stock has soared 47% over the past year, to almost 45 as of Jan. 9.

SAFE HARBORS

DEKKERS IS EXPERIENCED in the challenges of consolidating businesses. Raised in the Netherlands, the chemical engineer came to the U.S. in 1985 to work at General Electric Co.'s research unit in Schenectady, N.Y. After moving into management at Honeywell International, he arrived at Thermo in 2000 as chief operating officer and helped merge 24 publicly traded entities, each with its own stable of brand names, into one leaner corporation.

Security products are a big part of Dekkers' expansion plans. Last July the feds tapped Thermo and two competitors, Raytheon and Canberra Industries, for a \$1.2 billion pilot project to install next-generation scanners, starting with New York and New Jersey's ports. Thermo says the contract will be worth \$200 million over five years. A Democrat-controlled Congress may mean yet more orders. Republicans spent billions to protect airports but much less on ports. "Democrats have been yelling about this for years," says Brian W. Ruttenbur, a Morgan Keegan & Co. analyst in Nashville who covers companies active in homeland security. ■



RADEYE Handheld radiation detector from Thermo Fisher



Maribel Martinez Lieberman
Chocolatier, Owner of ManeBelle New York

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BlackBerry

The Small Fry Sour on Search Ads

iced out by brand giants, the outfits that pioneered the medium are looking elsewhere

ROBERT D. HOF

FOR YEARS, RUNNING THOSE little four-line text advertisements on Web search engines brought in a profitable stream of new customers to BabyAge.com. But last year, search suddenly turned sour. The eight-year-old online baby product store, which posted about \$20 million in sales. Even as BabyAge's \$1.2 million worth of search ads got more clicks in 2006, they netted fewer actual buyers, nearly doubling their cost. "We're not in business at this rate," fumes Chief Executive Jack Kiefer. Kiefer wants to cut back on search ads this year.

Kiefer isn't the only one casting a more critical eye on what has been the fastest-growing and most profitable Internet advertising medium. So are midsize and small retailers such as Overstock.com, luggage seller eBags, and home-electronics store eCost.com. Their ads, which run on search engines like Google Inc., Yahoo!

and other search sites when some companies in "diamond necklace" or "golf player," used to be the market's go-to choice for these outfits. They reached more targeted audiences and could be measured for effectiveness. But the price per click on those ads has risen—by an average of 31% from a year ago in the third quarter, according to DoubleClick Inc. Some merchants are looking seriously at alternatives—even, in some cases, print and radio spots. The fallout from a new online ad rush. Brand giants from Best

Buy Co. to Zale Corp. are diverting more and more of their marketing budgets to search ads. They're driving up prices and stealing customers from some of the smaller businesses that have bought the bulk of those ads. Web users have learned to shop around more, and now, instead of clicking on ads from the little guys and buying from them on the spot, they're often buying from the big brands they know well. If many of the small and midsize companies that pioneered this ad medium get disillusioned, search ads could lose their luster.

For the time being, Google's not worried. The rush of ad dollars from big brands into search is more than making up for any cutbacks by smaller outfits. National marketers from General Motors Corp. to Wal-Mart Stores Inc. are for the first time dedicating branding budgets to search, says Matt Greitzer, search director at Web marketing firm Avenue A/Razorfish. And Google and Yahoo say that even small companies with



the right products and message can still trump big brands online. "We're not seeing any erosion of ROI [return on investment] across the board by our customers," says Richard Holden, Google's director of product management for advertising.

Still, many small and midsize marketers are buying far fewer "keywords" and phrases. Merchants are also trying out ads on MySpace and YouTube, or advertising on blogs and niche shopping sites. Says consultant Andy Beal of Marketing Pilgrim: "The free lunch is over." ■

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Private Equity Repellent

Why some companies are intentionally taking the bloom off their balance sheets

BY DAVID HENRY

THREE WEEKS BEFORE Home Depot Inc. CEO Robert L. Nardelli resigned, Standard & Poor's downgraded the company's credit rating, citing the retailer's "more aggressive" financial policy. In the past year Home Depot had taken on \$5 billion in new debt and tapped two-thirds of its cash reserves to buy back shares and increase dividends. The moves were

a sop to angry shareholders who had been pestering Home Depot to boost the stock price.

Nardelli, of course, won't be around to see how his maneuvers play out; he quit over pay issues. Yet Home Depot illustrates new thinking about corporate balance sheets. The underlying logic seems counterintuitive: By weakening the financial picture to return cash to shareholders, corporate managers can preempt shareholder challenges. At the same time, they make the balance sheet

less enticing to voracious private firms. Leveraging up, the thinking can kill two birds with one stone.

Many companies are buying in. buybacks and dividends, all the recently, are starting to outstrip p In 2006, for the first time since cash held by nonfinancial compan the Standard & Poor's 500-stock



**This test had a lot of turns.
And one big twist.**
(Ford Fusion beat Camry and Accord.)

BOLD MOVES





solid over the years. According to a recent study by UBS equity strategist David Bianco, companies in the S&P 500 could increase their debt to still-prudent levels in 2007, return excess cash to shareholders, and raise the index's value 3% to 5%.

Such thinking is showing up at a wide range of companies. At the Hershey Co., spending on share repurchases exceeded free cash flow by \$1 billion over the past four years, estimates B. Craig Hutson, an analyst at Gimme Credit. S&P changed its outlook for Hershey's A+ rating to negative in October. Hershey declined to comment. Similarly, Computer Sciences Corp. last year embarked on a \$2 billion buyback campaign, partly with borrowed money, a move that prompted a downgrade from S&P to A-. And Expedia Inc. saw its rating threatened last month when S&P sized up its repurchase plan and changed its outlook to "negative." Both companies declined to comment.

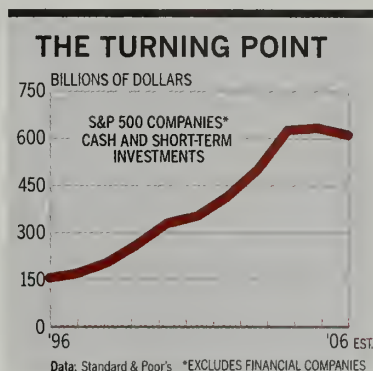
Among "investment-grade" borrowers, cash as a percentage of total debt has decreased from 17.5% in January, 2005, to 12.5%, according to Gregory J. Peters, chief credit strategist at Morgan Stanley. Yet that's still more than the historical

average of 10%, says Peters, and merely leaves balance sheets "less pristine."

Bondholders hate the change; they're losing safety without getting higher returns. Then again, a willful shift toward leverage could be the lesser of two evils, the other being a leveraged buyout. LBOs pile on debt and of-

ten turn "investment-grade" bonds into junk.

At Home Depot, spokeswoman Paula Drake responded in an e-mail that "returning value to our shareholders is a top priority and the strength of our balance sheet enables the company to do so." That may well be. In other words, weaker is better, at least for now. ■



ed, according to S&P senior index
st Howard Silverblatt. He pegs the
at about 4%, based on preliminary
Cash decreased "for a significant
er of companies," he says, perhaps
han two-thirds.

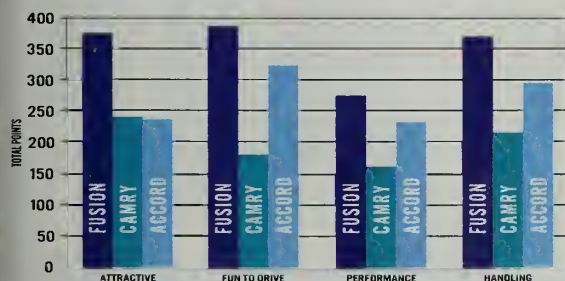
lurch toward debt isn't as danger-
it sounds. Many experts say execu-
ave made their balance sheets too

Recently, in Washington, D.C., a town known for its strong opinions, *Car and Driver* magazine held a head-to-head comparison. Six hundred car enthusiasts were asked to compare three cars in performance, handling and styling.

So, who won? Camry? Accord?

Actually, the all-wheel-drive Ford Fusion came in first – a fact that surprised a lot of people, but not *Car and Driver*.

Check it out yourself. Visit a Ford Dealer or go to fusionchallenge.com.



Results from 600 drivers who were asked if the cars were attractive, fun to drive, performed well and handled with precision. "Yes" responses scored one point. "No" responses scored zero. The results speak for themselves.

FUSION
Ford
CHALLENGE



CAR-DRIVER



Who Will Run the Plants?

As the nuclear industry starts to expand again, it faces a graying workforce

BY ADAM ASTON

IF YOU WALK THE HALLS OF WESTINGHOUSE or GE Nuclear, the top U.S. builders of atomic power plants, you'll notice a buzz in the air—the first stirring of excitement since the 1970s. With many experts endorsing nuclear power as a clean replacement for coal-burning plants linked with climate change, nuclear players are gearing up to build more than 20 reactors, the first new facilities on U.S. soil in decades.

But roaming the same hallways, something else seems odd: There are practically no young people. After years lying dormant, the industry faces a dire labor shortage, and it will get worse during the next 5 to 10 years as thousands of aging workers drift off to golf courses and retirement homes. So plant builders and utilities are frantically searching for fresh talent. If the industry is to have any future, “young workers are the key,” says Howard J. Bruschi, a retired chief technology officer at Westinghouse Electric Co. who helped design the company's newest reactor, a model that has been selected for 10 projects in the U.S.

The dilemma dates from the late 1970s, when skyrocketing costs began to chill investor enthusiasm for new plants. In 1979 a partial meltdown at Pennsylvania's Three Mile Island doomed the industry's optimistic vision of 1,000 atomic plants. Hiring stalled, and nuclear engineering programs at universities stopped churning out graduates. In short, a whole generation of nuclear workers went missing.

Today, the average age in the nuclear power sector is 48—one of the oldest of any U.S. industry. By 2010 about 27% of these workers will be eligible to retire—some 15,600 men and women. A further 7,600 or so are expected to exit the industry through turnover. That entire head count will need to be replaced to keep today's fleet of 104 reactors humming.

Factor in projected growth, and the situation is even more serious. A substantially larger workforce will be needed by 2010, when the first of two dozen proposed reactors enters the long design and construction process. Overseas, 27 plants are under way, 62 are on order or planned, and an additional 130 have been proposed.

Even if only a fraction of those plants are built, the industry faces a “severe shortage of qualified workers,” according to the American Nuclear Society. “We're probably getting 80% to 90% of what we need,” says Andy White, president and CEO of GE Nuclear Energy Inc., whose reactors have already been selected for seven new U.S. projects.

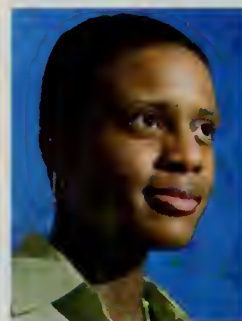
NO EMISSIONS

IT'S EASY TO SEE why some industry executives have started to fret. It can take years for new hires to master the industry's complex procedures and absorb its safety-obsessed culture. “Five years ago, we didn't dream we'd be building on this scale again,” says Amir Shahkarami, senior vice-president for engineering

and technical services at Exelon Corp., the nation's largest nuclear utility. Exelon operates 17 reactors today and is considering one new facility. An aging workforce will result in a substantial loss of experience, Shahkarami says.

Just how quickly college grads crank out such highly specialized engineers remains a question. Some 34 nuclear engineering departments have closed since 1980, leaving just 29 left. By the late 1990s, the number of undergraduate students enrolling in such programs had fallen to fewer than 500 a year. In the past several years, enrollment has again begun to rise. In 2007, total nuclear engineering majors in the U.S. will approach 2,000, predicts John Guttenberg, director of university programs at the Energy Dept.

Several factors account for renewed interest on campuses. Starting salaries in nuclear power jumped last year, to about \$54,600. In addition, today's students are far more worried about global warming than they were of a nuclear meltdown or the prospect of waste disposal. Coming of age after the disasters at Three Mile Island and Chernobyl, new hires in the sector tend to regard atomic energy as a plausible solution to America's energy woes—as did the engineers who trained the first generation of nukes. They



LOCKRIDGE One of Westinghouse's first new hires after a long freeze

that plants can help curb the greenhouse gas is a huge plus. “It's not to be sure we can plug in iPods, sort of,” says Ms. Yun, a recent hire who joined the company as a licensing engineer last year.

DeLeah Lockridge, a senior engineering unit, is the first new hire by the prospect of a new plant construction. When she

joined the company in 1999—one of the first new hires following a long freeze—Lockridge worried that nuclear might be a dying industry. “I didn't expect to have the opportunity my instructors had,” she says. “Now, I want to build a plant.” ■



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Changing the Game on Nike

How budget sneakers are tripping up its basketball business

BY STANLEY HOLMES

LIKE THE NATIONAL Basketball Assn.'s top-tier Dallas Mavericks, Nike Inc. continues to display a potent offense. Its recent second-quarter profit surged 8%, to \$326 million, and sales jumped 10%, to \$3.8 billion. The stock, up about 15% over the past 12 months, continues to fly high. "The brand is strong," Nike CEO Mark Parker told analysts in December. "The company is growing."

But the sporting goods giant is facing a full-court press at the heart of its U.S. business: basketball footwear. Industrywide unit sales of basketball shoes dropped 16% last year, says market research firm SportScanINFO. And Nike, which counts on basketball gear for an estimated 30% to 40% of its U.S. revenues, acknowledged last month that footwear inventories were 15% higher than a year ago.

Running shoes and the apparel business remain strong, but John Shanley, who tracks the industry for Susquehanna Financial Group, says Nike will have to sell a lot of shoes in the coming weeks or suffer a possible hit to earnings. Nike CFO Donald Blair told analysts he believed the inventory overhang would not "have a material negative impact."

Nike has been the king of the basketball sneaker

since the 1980s, when Michael Jordan-branded shoes first became a fashion statement on and off the court. But the current Jordan line is losing some cachet among suburban and inner-city kids. While a new release of the Air Jordan Retro did well over Christmas, some of the latter-day Jordan models are being sold at unusually deep discounts.

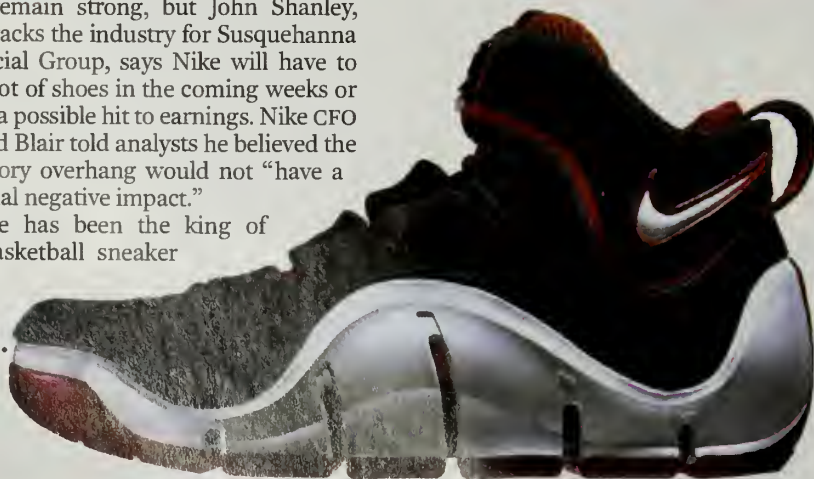
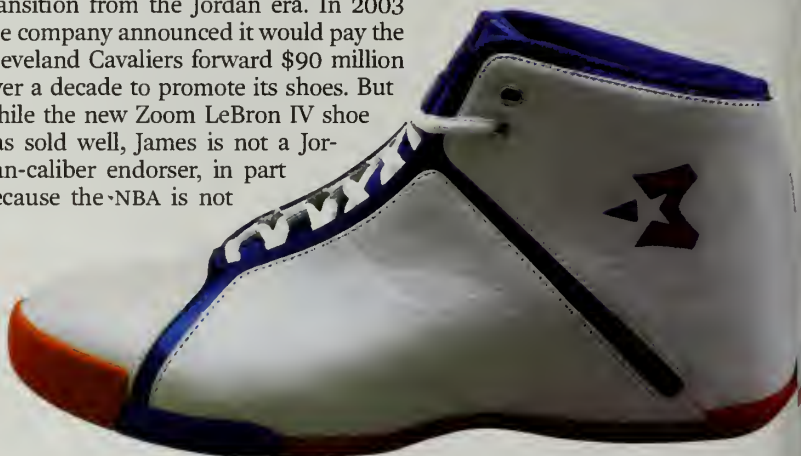
Nike has been betting on NBA up-and-comer LeBron James to help it make the transition from the Jordan era. In 2003 the company announced it would pay the Cleveland Cavaliers forward \$90 million over a decade to promote its shoes. But while the new Zoom LeBron IV shoe has sold well, James is not a Jordan-caliber endorser, in part because the NBA is not

the draw it was when Jordan was a star.

It's no secret that for the past few years kids have been trading in their high-top for skateboarding shoes made by the likes of Vans, DC, and Skechers. But the news in the sneaker world is the advent of the cheap basketball shoe. Case in point: the Starbury One, which sells for \$14.98. Made and sold by the discount clothing chain Steve & Barry's, the sneaker is endorsed by New York Knicks guard Stephon Marbury, who says 3 million pairs have sold since its August debut.

The Starbury and its ilk have the potential to undermine Nike's basketball sneaker business. According to researcher Group Inc., the low-cost shoe market has grown nearly 9% over the past two years and now makes up more than half of the \$16.5 billion in branded athletic footwear sold each year in the U.S. Nike sells its own cheap sneakers, but doesn't have much traction against

Nike
Zoom LeBron IV
\$150



such low-cost entrants as the \$35 Ameri, a creation from Payless Shoes. "If I were a branded athletic company right now, I'd be reconsidering my approach," says Jeffrey Bliss, president of Javelin Group, a sports marketing firm.

Nike has overcome big challenges before. It continues to dominate the basketball sneaker market and still sells \$100-plus shoes. It has a hit with Converse Inc. Dwayne Wade, a star endorsed by the Miami Heat guard, retails for \$100. Thanks to strong demand for the shoe, Nike says revenue from the Converse unit rose nearly 50% during its most recent quarter. The question for Nike is whether the current hunger for sneakers is building long-term momentum or is little more than a fad. ■

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King of His Digital

Net guru John Patrick has built the ultimate automated house. Dim the lights

MICROSOFT CHAIRMAN BILL GATES may have electronic art on the walls of his \$50 million home outside Seattle and personalized music piped into each room. But a house with an even bigger technological wow factor is the 6,000-square-foot digital domain in Connecticut owned by one John Patrick, a 38-year IBM veteran who spearheaded Big Blue's Net strategy in the late 1990s.

At Patrick's suburban castle, almost everything that can be automated is, and it's all tied together in a network that acts like a central nervous system for the house. We're talking security, music, TVs, computers, home theater, lighting, heat and air conditioning,

garage doors, window shades, propane, backup electrical generator, and outdoor spa. Many homes have bits and pieces of this setup, whether a security system or home theater, but few have them all, much less central controls to link them together.

The brain is a closet-size space tucked between the kitchen and Patrick's office. It's packed from floor to ceiling with electronic gear—more than a dozen computers in all, plus his-and-hers digital video recorders, a CD player, and a VCR. The computers all run the Unix operating system, like many high-powered computers at corporations.

This room is also where Patrick's home network connects with the outside world. A cable-TV line is split to his video, wired and wireless Internet access, and phone service. The computer room isn't big enough to hold the half terabyte storage device where he keeps his digital content. That refrigerator-size machine is in the basement where his music collection totals 20,000 titles, with no fewer than 7,000 by Mozart, his favorite composer.

Patrick, 61, who grew up in southern New Jersey, is a consummate tinkerer. An electrical engineer by training, he's totally into gadgetry. "Most people love golf or sports or cars. I love technology," he says. He caught the home gadgetry bug when he saw a similar home office in his previous house in the late 1990s. When he and wife Judy decided to build a dream house on



Castle

sic—even from half a world away. **BY STEVE HAMM**

a few miles away, Patrick went into propeller-head mode. “I wanted to automate everything that could be automated, as long as it was practical,” he says. It took two years to see his scheme through. The Patricks moved into their new home in April, 2002.

GETRY OVERLOAD

IT WASN'T A ONE-MAN JOB. Patrick was assisted by Rob Gerhardt, a sales engineer from Phoenix Audio Video, an electronics contractor; a team of programming and electronics experts, as well as a software programmer. They brought their heads together to design the system and customize the touch pads mounted on walls around the house. A project like this can create serious headaches for homeowners. Patrick warns not to make things overly complicated. They might be too difficult to use,

especially for family members who don't appreciate gadgetry. Also, it's hard to find contractors with a holistic view. Most know one thing well—say, security. This stuff can be frightfully expensive. And while Patrick declines to say what he spent on gadgetry, experts say automation can run to 10% of the cost of a new home. But if you do a few simple things, such as lighting, it won't cost that much. Much of the gear is available at electronics stores.

My tour of Patrick's digital life started at a touch pad on the kitchen wall, one of seven of these 5-inch-square pads strategically placed around the house. The ultra-simple interface looks and works like a Web page. There's a menu of services on the left including climate control, security, lighting, and vacation mode. On the right: musical choices selected by artist, album, or genre come from cable, radio tuner, Internet, satellite radio, and

CDs. You can control any electronic system in the house from any pad. “I'm not too technical,” says Joanne Patrick. “I don't know how to program a VCR, but I can operate these wall panels.”

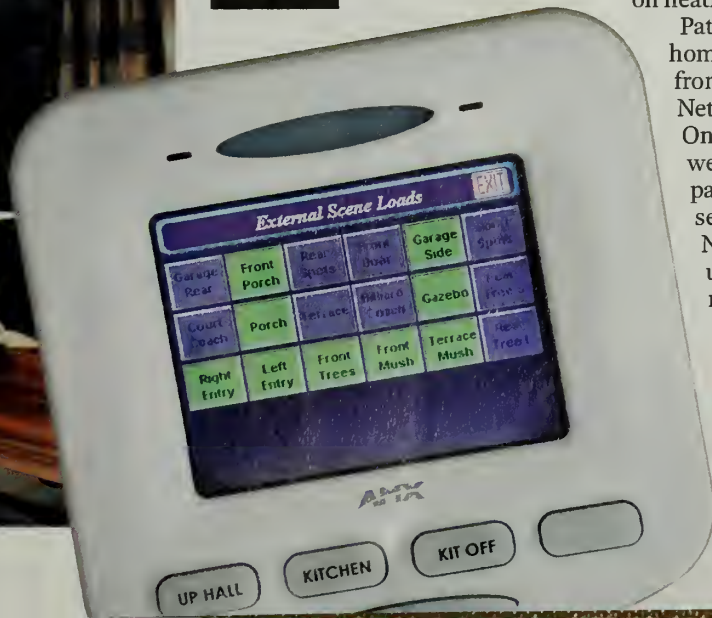
In addition to the touch pads, every room in the house has a 16-button lighting control panel. Besides switching on or off individual lights or clusters, the controls can activate what Patrick calls “scenes.” Press the “Go to Bed” button, for example, and the path to the master bedroom upstairs is illuminated, while downstairs lights are turned off.

Not all the features demand human intervention. Patrick scattered 50-or-so electronic sensors around the house and grounds to monitor the property. There's one in every door and window. Sensors detect whether the sun is out and at what angle it strikes the house so shades are automatically drawn or opened. If a car pulls into the back driveway, a “beep-beep” sounds at each touch pad. From his office desk, Patrick can flip on his TV and tune to the “courtyard cam” channel, which shows the driveway. If he likes what he sees, he'll press a button on the touch pad to open a garage door. Each of the household's cars and motorcycles is rigged with a radio-frequency ID tag so when one pulls into the driveway, the proper garage door opens.

Patrick's outdoor spa, set in a backyard deck and surrounded with shrubs, may be the home's coolest feature. From a comfortable spot in the water, you can easily reach a touch pad that's embedded in a fake rock to control the jets, water temperature, and a mini-waterfall, and to adjust the volume on audio speakers hidden in other fake rocks. (Hey, they're good fakes.) Sensors can also detect snow on the deck and automatically turn on heating elements to melt it.

Patrick can control his home automation gear from his laptop, via the Net, when he's on the road. Once, when his alarm went off and the police paid a visit, he reset the security system from New Zealand. That's the ultimate kick for Patrick: He sees his home as just another stop on the Internet. ■

PATRICK'S PAD One-touch digital panels throughout his house, and handheld remotes, give John Patrick control of everything from window blinds to satellite radio



BusinessWeek.com

To see a video report on the wired home featured in this story, go to www.businessweek.com/go/tv/wiredhome.



BY MIKE MARRONE

The One Album I Can't Stop Playing

BEFORE WE CHARGE into a brand new year of music, I want to spend one more column on an album that was released in 2006—October, to be exact. Although I am often asked what my real personal favorites are, I rarely make lists because I'm always afraid of leaving something off. But I can safely attest that *Live A Little* (Ashmont), the sixth full-length release from the Pernice Brothers, is not only my absolute favorite album of 2006 but will unquestionably reside on

my list of Best Pop Albums of all time.

Now, there are countless genres and subgenres of rock music, so what exactly is pop rock? By strict definition it means "popular music," but to me it's a style of rock sometimes called "power pop" that is best exemplified by songs like *No Matter What* by Badfinger, *Time Of The Season* from the Zombies, or even the Grass Roots' classic *Bella Linda*. Think of Beatles' tunes like *And Your Bird Can Sing*, *Girl*, and especially *I'll Be Back*, or the Beach Boys' *In My Room*. To someone in my age group (50s), it's the sound of days gone by, of playing your 45s outside on a summer afternoon. Even the sad songs make

you feel as if the sun is shining.

Live A Little contains elements of each of the songs mentioned above, but the Pernice Brothers are not mere nostalgia practitioners living off the sounds of rock's golden age. Joe Pernice—the songwriter, lead singer, and co-owner of the Ashmont record label with the band's manager, Joyce Linehan—is a literate songwriter who has managed to incorporate such classic pop influences along with those of lesser-known pop gems such as *Hand In Glove* by the Smiths, *All Going Out Together* from Big Dipper, the Cure's *Boys Don't Cry*, and *Senses Working Overtime* from XTC, to name but a few. Acoustic and electric

6- and 12-string guitars, piano and organ, drums and analog synths play with lovely harmonies, real strings horns, and masterful songwriting.

Zero Refills is a highlight, with Joe Pernice's angelic falsetto displaying a hint of rasp. The guitar hook made me think of an old Gilbert O'Sullivan song that I'm almost embarrassed to admit remembering, *Alone Again (Naturally)*, but I'm not sure why since there was no guitar to speak of in that song. The even real strings and a trumpet solo.

My personal favorite from the album finds Joe going back to an older song from his days in the Scud Mountain Boys (1994-1997) and reinventing it as *Grudge F---* (2006). Think of *Let It Be* by the Beatles mixed with Badfinger's *Maybe Tomorrow* and Bread's *Making a Fool of Yourself With You*, and add more strings and lyrics so true they may make you cry. Even though the title suggests it, the word is not a curse word to be found.

Head to pernicebrothers.com for the full back story on the band and plenty of audio and video samples. For the three months I have been unable to get this album away. I play it every day on the radio, in my car, or at home. Every song sparkles, and like only the best albums, it's over far too soon. ■

Mike Marrone is program director of XM Satellite Radio's *The Loft*, a channel that on an eclectic mix of singer-songwriters from the 1970s through the present.



PERNICE BROTHERS
Peyton Pinkerton,
James Walbourne,
Joe Pernice, and
Patrick Berkery



BY ROBERT PARKER

These Pinot Noirs Live Up to the Hype

THANKS TO THE 2004 MOVIE *Sideways*, pinot noir has become absurdly popular. To be told, most of this wine, whether domestic or imported, is of little interest and often overpriced. The following wineries' pinot noirs, however, play the true glories of this grape. All are from the 2004 vintage in California's Santa Rita Hills, the wine country northwest of Santa Barbara where the film takes place.

Smoke Cellars

95 points. A dense ruby/purple color accompanied by aromas of black currants, blackberries, and a hint of flowers. Tightly, sweet tannin, enough to provide freshness and definition, and a textured, mouthfeel give this wine a charm that makes it enjoyable now. Still, this wine possesses enough concentration and length to last a decade. \$30

Estate Rancho Santa Rosa

95 points. Cherry, plum, and peatlike characteristics present in this well-made, full-bodied effort. With a strongly plush texture, it is California's version of a top-notch premier cru from Burgundy. \$38

Attila-Ostini Hitching Post Vineyard

95 points. This pinot noir is a brilliant effort bringing aromas of flowers and forest floor mixed with black cherries, plums, and more. It's a complex, medium- to full-bodied wine with a deep ruby/purple color, tannin, and enough acidity to provide a focus. It is a charming, seductive wine to enjoy over the next five to seven years. \$40



Melville Clone 115 Indigène

95 points. Sweet forest floor, jammy cherry, strawberry, and a hint of blueberry-like aromas roar from the glass of this full-bodied wine. With fabulous intensity, as well as purity, and brilliant nuances, richness, and depth, it is a classic Santa Rita Hills pinot noir to drink over the next five to six years. \$42

Foxen Vineyard Sea Smoke Vineyard

96 points. This pinot noir's ruby/purple color and its intense, glorious perfume of sweet kirsch, black currants, flowers, and underbrush suggest a wine built for the

long haul. Tremendous opulence, richness, and intensity in addition to a dazzling finish with great flavor and precision result in one of the finest Central Coast pinot noirs I have ever tasted. It can be enjoyed over the next decade. \$64

Brewer-Clifton Melville Vineyard

95 points. First you notice a deep ruby color, and then you pick up wonderful aromas of forest floor, strawberry jam, black cherries, and flowers. In the mouth, notions of plums, cloves, and sweet cherries are presented in a broad, savory style with enormous richness and concentration but no sense of heaviness. This offering should drink well for 10 or more years. \$64

Sine Qua Non Covert

Fingers Arita Hills Vineyard

95 points. A knockout effort, this deep ruby/purple/plum-tinged pinot exhibits a slightly restrained nose, revealing sweet cranberry and cassis aromas interwoven with hints of flowers, charcoal, and oak, a savory, broad texture, and an opulent, voluptuous finish. This beauty should drink well for at least a decade, probably longer. \$75

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, *The Wine Advocate*.

Scores from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras

Meet the Funds That Perform

BusinessWeek's Scoreboard takes the guesswork out of picking mutual funds. **BY LAUREN YOUNG**

WHAT DO HUNTING DEER, PLAYING HOCKEY, and picking stocks have in common? They're all about taking the right shots. James Diedrich and Hal Goldstein, the 48-year-old co-managers of the \$1.6 billion First American Mid Cap Growth Opportunity Fund, always aim carefully. Diedrich journeys to the woods of Wisconsin to hunt deer with a bow and arrow. Since state game laws allow a bow hunter only one buck a year, "I see many deer before taking a shot," he says. Goldstein dons 10 pounds of gear to play wing in a hockey league. "I'm playing hockey for the fun and camaraderie," he says. "But when I get on the ice, I want to win." ¶ At their day jobs, the duo

applies the same kind of discipline to managing their investors' money. They zoom in on high-quality companies that are historically cheap yet show above-average earnings and revenue growth and strong cash flow. Instead of taking big bets on hot stocks, they spread their risk among 80 companies. When a stock hits its price target, these managers simply sell. Because of this disciplined investment strategy, First American Mid Cap Growth delivered an 11.2% average annual total return for the five years ending Dec. 31, vs. 6.4% for the typical mid-cap growth fund. That earned Diedrich's and Goldstein's fund an A rating from the *BusinessWeek* Mutual Fund Scoreboard

in the mid-cap growth fund category.

There may be mid-cap funds with better returns in any given year. But the scoreboard, which we've been publishing for more than 20 years, doesn't give much credibility to one-year wonders. Instead, it highlights funds that take the right shots again and again, year after year.

From a list of 6,061 stock and bond funds, the scoreboard identifies a select group that earned the best risk-adjusted returns in the past five years. That's why the scoreboard, available at businessweek.com/extras and updated monthly, is an ideal place to get fresh investment ideas or check up on what you already have in your portfolios.

In addition to turning up some known names, the scoreboard lights dozens of standouts at giant mutual fund companies such as Vanguard, Fidelity Investments, T. Rowe Price, and American Funds. The scoreboard includes exchange-traded funds so you can check on their track records and how they measure up to their mutual fund rivals.

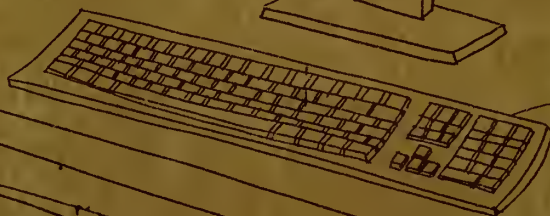
DRILLING DOWN

TO GET A RATING, a fund must have a performance history of at least five years. With data prepared for *BusinessWeek* by Standard & Poor's, which is a unit of The McGraw-Hill Companies, we measure each fund's monthly performance for the past 60 months. If a fund fails to beat the return of risk-adjusted 90-day U.S. Treasury bills, it earns a minus sign, which is subtracted from the total return to come up with an adjusted return. Funds are then ranked by their risk-adjusted returns from A (superior) through F (very poor). The A funds are best, B+ or even B- funds are still worth a serious look.

BusinessWeek awards two stars to each fund. An overall rating compares the performance of equity funds against all other stock funds. (For bond funds, we compare taxable to other taxable bond funds, and do likewise for tax-free funds.) You'll find plenty of emerging-market and natural-resource funds among the 216 earning A ratings, which isn't a surprise given the worldwide demand for commodities the past few years. But to build a diversified portfolio, you need a lot more investments based on emerging markets and natural resources.

That's where the category ratings come in handy. These are especially useful when you're trying to find a good fund in a sector that has been in favor, such as large-cap growth, health care, and is unlikely to slip in the overall ratings. The scoreboard features ratings in more than 50 stock and bond categories, many of which you can find in the tables on pages 90-91. The rest is online at businessweek.com, along with data on 1-, 3-, 5-, and 10-year returns; sales charges; expense ratios. To drill down further, you can examine portfolio data on a fund's risk and cash levels to unearth real gems.

One common theme many mutual funds share is a buy-and-hold philosophy, and the scoreboard also can help you identify funds with low p



By sifting through the portfolio data, the scoreboard also helps you pinpoint funds that keep a lid on risk. (You can find a fund's risk level by clicking on "risk" at the top of the scoreboard.) Two standouts include AIM European Growth, which has an overall rating of A and an annualized 21.6% return during the past five years, and AIM Interna-

SMOOTHER SEAS. LOWER TAXES

CLAS OLSSON oversees AIM's international growth group from an unlikely perch: Austin, Tex. Considering that Olsson was once a naval officer in his native Sweden, it makes sense that he tries to provide returns that mimic smooth seas. One smart bet has been Puma, the German sports apparel manufacturer. At the start of the decade, Puma was an underutilized brand, though Olsson recognized its value as a fashion powerhouse. Instead of going head to head with Reebok and Nike in categories like basketball and running, Puma focused on the fash-

BusinessWeek's Mutual Fund Scoreboard rates funds based on the past five years' pretax total return, adjusted for risk. Here we show the equity funds that received A ratings for the best risk-adjusted return against similar funds. You can find more categories, plus overall equity ratings at businessweek.com

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PATIENT HUNTER
First American's
Diedrich takes a
long, hard look
before he shoots

ionable side of footwear, and now it is the epitome of cool. "Market share in the U.S. has risen from 1% to over 3%—that's still tiny, but there's a lot more room to go," Olsson says.

Another key component of the scoreboard is aftertax returns, which are much harder to identify than total returns. Our calculations are based on each year's highest federal tax rates for dividends and capital gains. For those trying to minimize the tax bite of their fund holdings, this information is especially useful.

Investors have not sacrificed performance for a better tax bill at the A-rated Managers AMG First Quadrant Tax-Managed U.S. Equity Fund, a large-cap blend fund with \$85 million in assets. It has an 8.9% five-year annualized total return before taxes, and 8.8% after taxes. (The

typical large-cap blend fund delivered an annualized total return of 5.7% in the same time period.) The fund sells its losers in order to "harvest" losses to offset gains. "The fund has not distributed capital gains in the six years I've managed it," says manager Christopher Luck. Because the fund still has \$52 million in losses on its books, he doesn't expect to distribute a capital gain in the next three years, either.

The scoreboard will also guide you to the best bond fund opportunities. Under taxable funds, you'll find government funds, which own U.S. Treasury and agency-issued securities. General bond funds are covered, too, holding mainly corporate and government debt. Our more specialized fixed-income categories include high-yield and international bonds. The tax-exempt funds are

AVERAGE ANNUAL TOTAL RETURN (%)*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN (%)*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN (%)*	
7.9	ORTY INSTL. JACAX	» Mid-Cap Blend			
7.7	JAVLX	15.2	BRIDGEWAY MICRO-CAP LIMITED BRMCX	12.8	
10.5	GROWTH TRUST PRIMARY LMGTX	14.2	BRIDGEWAY ULTRA SMALL COMPANY BRUSX	24.8	
8.9	E GROWTH MTRPX	13.4	COLUMBIA ACORN Z ACRNX	14.7	
15.8	CENTURY MXXIX	13.8	DREYFUS PREMIER ENTERPRISE A DPMGX	16.2	
7.8	SMFOCX		FBR SMALL CAP FBRVX	20.8	
7.4	TH MGRIX		HENNESSY CORNERSTONE GROWTH HFCGX	14.9	
7.6	SGRX		N/I NUMERIC INVESTORS EMERGING GROWTH NIMCX	15.0	
8.7	MANAGED GLBL. EQUITY S RTGSX	10.8	OBERWEIS MICRO CAP OBMCX	15.1	
6.7	INVESTERS CAPITAL GROWTH M MARBX	13.3	PERRITT MICRO CAP OPPORTUNITIES PRGTX	20.2	
7.2	PREMIER EQUITY INV. TEQUX	11.3	WASATCH MICRO CAP WMICX	13.5	
6.5	MAN GROWTH INV. VMRGX	11.2	WILLIAM BLAIR SMALL CAP GROWTH N WBSNX	14.5	
8.4	MECAP VPMCX	11.7	» Small-Cap Value		
6.6	ADVANTAGE CAPITAL GROWTH INV. SLGIX	14.3	FIFTH THIRD MICRO CAP VALUE INSTL. MXAIX	18.7	
Cap Value		12.2	GARTMORE SMALL CAP A GSXAX	19.1	
12.9	DEND VALUE A PNEAX	11.0	HOTCHKIS & WILEY SMALL CAP VALUE I HWSIX	18.6	
12.2	FUNDS TRUST INCOME AMANX	11.9	JAMES ADVANTAGE SMALL CAP JASCX	18.0	
12.0	LARGE CAP VALUE PLANAHEAD AAGPX	11.7	MAINSTAY SMALL CAP OPPORTUNITY I MOPIX	18.6	
13.2	GE CAP VALUE INV. A MDLVX		N/I NUMERIC INVESTORS SMALL CAP VALUE NISVX	19.5	
12.8	OCK DODGX	17.0	PACIFIC ADVISORS SMALL CAP A PASMIX	20.0	
11.3	E & RESTRUCTURING UMBIX	26.0	RS PARTNERS A RSPFX	22.4	
10.8	MIHX	17.9	ROYCE VALUE PLUS SVC. RYVPX	21.6	
13.9	D ADVANTAGE HCMAX	17.2	SCHNEIDER SMALL CAP VALUE SCMVX	24.3	
14.0	Y LARGE CAP VALUE A HWLAX	23.1	» World		
11.5	LEADERS TRUST SERIES B A LEXCX		DWS GLOBAL OPPORTUNITIES S SGSCX	16.4	
10.9	3000 VALUE INDEX IWW	16.5	DELAWARE GLOBAL VALUE A DABAX	18.5	
13.1	CLASSIC VALUE A PZFXV	21.1	OAKMARK GLOBAL I OAKGX	18.8	
11.2	ALUE INSTL. LSGIX	13.7	PEARL AGGRESSIVE GROWTH PFAGX	16.1	
11.8	EX Z BEGRX	14.4	POLARIS GLOBAL VALUE INVESTOR PGVFX	21.0	
10.9	U MUTHX	14.1	TEMPLETON GLOBAL SMALLER COMPANIES A TEMGX	18.8	
13.9	VALUE A CVFCX	16.7	VANGUARD GLOBAL EQUITY VHGX	17.7	
13.2	ERSIFIED EQUITY INCOME A INDZX	» Small-Cap Blend			
11.2	D CUSED N TGIGX		AMER. CENTURY SMALL COMPANY INV. ASQIX	16.5	
12.1	V. JE OPPORTUNITIES Z CCEVX	16.5	BRIDGEWAY ULTRA SMALL COMPANY MARKET BRISX	21.1	
		21.1	CENTURY SMALL CAP SELECT INSTL. CSMCX	13.7	
		13.7	LAUDUS ROSENBERG U.S. DISCOVERY INV. RDIVX	14.4	
		14.4	MORGAN STANLEY INSTL. SMALL CAP VALUE MPSCX	14.1	
		14.1	SATUIT CAPITAL MANAGEMENT MICRO CAP SATMX	16.7	
		16.7	» Small-Cap Growth		
			BOGLE SMALL CAP GROWTH INV. BOGLX	14.4	

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1, 2002-Dec. 31, 2006

Data: Standard & Poor's

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1, 2002-Dec. 31, 2006
Data: Standard & Poor's



GOAL-ORIENTED
Goldstein, of First American, plays to win both on and off the ice

categorized by maturity, and whether they are national in scope or focus on a single state.

Since bond returns can be purchased with careful attention to funds with low expenses, such as the A-rated \$4 billion Vanguard Intermediate Term Treasury Fund (Admiral Shares), which costs \$10 for every \$10,000 invested. The yield curve has been a big challenge for fixed-income investors, which is why the fund has been buying shorter-term bonds to lower its sensitivity to interest rates. "With yields so low, there's a small margin for error," says Robert Auwarter, Vanguard's head of fixed income portfolio management.

As you may have heard, past performance is no guarantee of future return. By using the scoreboard to find funds with higher ratings, lower risk, and minimal expenses, you can improve your odds for success. ■

BusinessWeek.com For more on the Mutual Fund Scoreboard, watch our weekly TV show *BusinessWeek Weekend*.

To use our interactive fund table, go to businessweek.com/extras.

Tops In Bond Funds

Here we show the bond funds that received A ratings for the best risk-adjusted returns against similar funds. You can find more categories, plus overall bond fund ratings, at businessweek.com/extras.

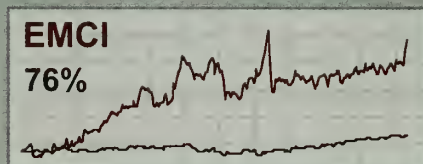
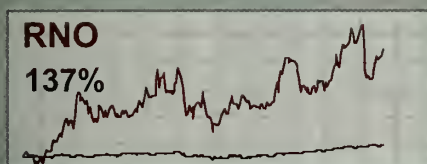
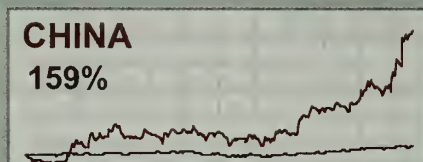
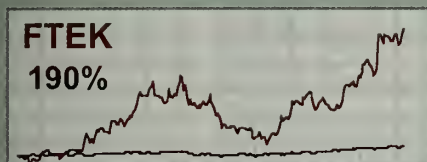
FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN (%)*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN (%)*	FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN (%)*
» High-Yield					
DELAWARE DELCHESTER A DETWX	12.0	WESTCORE PLUS BOND WTIBX	6.6	» Municipal National-Long	
DELAWARE HIGH YIELD OPP A DHOAX	11.7	WESTERN ASSET CORE BOND I WATFX	6.0	EATON VANCE NATIONAL MUNICIPALS A EANAX	
FIDELITY ADVISOR HIGH INCOME ADVANTAGE T FAHYX	14.0	WESTERN ASSET CORE PLUS BOND I WACPX	6.9	FIDELITY TAX FREE BOND FTABX	
FIDELITY CAPITAL & INCOME FAGIX	13.2	» Intermediate Government		OPPENHEIMER AMT FREE MUNICIPAL BOND A OF	
JOHN HANCOCK HIGH YIELD A JHHBX	13.8	AMER. CENTURY TARGET MATURITY 2010 INV. BTTNX	5.7	T. ROWE PRICE SUMMIT MUNI INCOME PRINX	
MAINSTAY HIGH YIELD CORP. BOND A MHCAX	12.1	FIDELITY MORTGAGE SECURITIES FMSFX	4.9	USAA TAX EXEMPT LONG-TERM USTEX	
REGIONS MORGAN KEEGAN SELECT HIGH INC. A MKHIX	12.2	JPMORGAN MORTGAGE-BACKED SEC. SEL. OMBIX	5.0	» Short (General)	
WM HIGH YIELD A CPHYX	12.5	PAYDEN GNMA R PYGNX	4.9	LEGG MASON PARTNERS LIFESTYLE INCOME A SO	
» Intermediate (General)		TCW TOTAL RETURN BOND I TGLMX	5.5	PHOENIX MULTI-SECTOR SHORT-TERM BOND A NA	
BAIRD CORE PLUS BOND INV. BCOSX	5.9	VANGUARD INTERM. TREASURY ADMIRAL VFIUX	5.1	THOMPSON PLUMB BOND THOPX	
COLUMBIA INCOME Z SRINX	6.4	» International Bond		VANTAGEPOINT MODEL SAVINGS ORIENTED GROWTH V	
CROFT-LEOMINSTER INCOME CLINX	7.0	OPPENHEIMER INTERNATIONAL BOND A OIBAX	14.5	SCHWAB INV. YIELD PLUS SELECT SWYSX	
DELAWARE CORP. BOND A DGCAX	7.8	PIONEER GLOBAL HIGH YIELD A PGHYX	15.3	» Short Government	
JULIUS BAER TOTAL RETURN BOND A BJBGX	7.2	TEMPLETON GLOBAL BOND A TPINX	12.9	ALLEGiant GOVERNMENT MORTGAGE I AUSIX	
LEGG MASON INCOME INV. GRADE PRIMARY LMIGX	6.4	» Municipal National-Intermediate		DWS GNMA S SGINX	
MANAGERS BOND MGFIX	7.4	OPPENHEIMER LIMITED TERM MUNICIPAL A OPITX	7.1	MANAGERS INTERM. DURATION U.S. GOVT. MGD	
MANAGERS FIXED INCOME INSTL. MFDYX	6.6	USAA TAX EXEMPT INTERMEDIATE-TERM USATX	4.9	PIMCO TOTAL RETURN MORTGAGE D PTMDX	
PIMCO INVESTMENT GRADE CORPORATE BD. INSTL. PIGIX	6.9	VANGUARD HIGH YIELD TAX-EXEMPT ADMIRAL VWALX	5.8	SENTINEL GOVERNMENT SECURITIES A SEG SX	
PARNASSUS FIXED INCOME PRFIX	5.8	VANGUARD INS. LONG-TERM TAX-EXEMPT ADMIRAL VILQX	5.6	» Ultrashort	
PIONEER BOND Y PICYX	6.3	WELLS FARGO ADVANTAGE INTERM. TAX-FREE INV. SIMBX	5.8	DWS SHORT DURATION PLUS INV. DBPIX	
REGIONS MORGAN KEEGAN SEL. INTERM. A MKIBX	6.8	WELLS FARGO ADVANTAGE MUNICIPAL BOND INV. SXFIX	6.8	SCHWAB INV. YIELD PLUS SELECT SWYSX	
T. ROWE PRICE CORPORATE INCOME PRPIX	6.3				

*Appreciation plus reinvestment of dividends and capital gains before taxes. Jan. 1, 2002-Dec. 31, 2006 Data: Standard & Poor's

4 TOP COMPANIES: AVERAGE 141% RETURN

Equity Investor's Small-Cap Review

The companies featured were among America's top domestically traded, with market capitalizations from \$100 million to \$2 billion, in terms of 12-month share price performance for the period ending 11/30/06. While past performance is never a guarantee of future results, these companies represent investment opportunities worthy of any Small-Cap investor's close consideration.



12-Month Share Price Performance for the period ending 11/30/06

● Stock ● S&P500

Fuel Tech, Inc.

Symbol: **FTEK**

Industry: Energy

IR Contact: Tracy H. Krumme

tkrumme@fueltechnv.com

Fuel Tech is engaged in the development of environmentally sustainable technologies designed to optimize processes and improve efficiencies in air pollution control and energy production. Using proprietary software, chemical injection strategies are formulated to treat the liquid/solid fuels combusted by utilities and industrial plants.



- MARKET CAPITALIZATION: \$538 mil.
- 12-MO REVENUE GROWTH: 65%
- 12-MO PRE-TAX INCOME GROWTH: 152%
- LOW CAP EX & HIGH MARGINS
- CASH ON HAND: \$26 mil.

Rio Narcea

Symbol: **RNO** (Amex)

Industry: Mineral Resources

IR Contact: Michelle Roth

michelleroth@rothir.com

Rio Narcea is a growing Canadian mineral resource company with operations, development projects and exploration activities in Spain, Mauritania and Portugal. The Company's Aguablanca nickel-copper mine is located in southern Spain. Its Tasiast gold project, in Mauritania, will be in production second half of 2007.



- MARKET CAPITALIZATION: \$413 mil.
- SHARE PRICE: \$2.63
- '06 9 MONTH NICKEL PROD.: 10.5 mil. lbs.
- EXPLORATION EXPENDITURES: \$8 mil.
- ADDED TO S&P/TSX GLOBAL GOLD IND.

CDC Corporation

Symbol: **CHINA** (NASDAQ)

Industry: Enterprise Software

IR Contact: Monish Bahl

monishbahl@cdcsoftware.com

The CDC family of companies includes the following business units: CDC Software, a provider of enterprise software applications and services; CDC Mobile, a provider of mobile applications; CDC Games, a provider of online games; and China.com, a provider of Internet services for the greater China markets.



- SOFT. LIC. REV (SLR): \$11.9 mil. up 35% y/y
- SLR FROM NEW CUSTOMERS: 46%
- GUIDANCE REV FOR '07: \$401-\$411 mil.
- 3RD QTR '06 REV: \$78 mil.
- 3RD QTR ADJ. NET INCOME: \$10.1 mil.

EMC Insurance Group Inc

Symbol: **EMCI** (Nasdaq)

Industry: Insurance (P&C)

IR Contact: Anita Novak

anita.l.novak@emcins.com

EMCI owns subsidiaries with operations in property and casualty insurance and reinsurance and is the publicly-held insurance holding company of EMC Insurance Companies. Products are marketed through independent insurance agencies in 41 states.



- MARKET CAPITALIZATION: \$473 mil
- DIVIDEND YIELD (11/30/06): 1.9%
- PRICE TO EARNINGS (9/30/06): 6.5 TIMES
- ROE (9/30/06): 20.0%
- TOTAL ASSETS (9/30/06): \$1.2 bil



BY GENE G. MARCIAL

NO DEFENSE CUTS LOOM ON LOCKHEED MARTIN HORIZONS.

SEMPRA ENERGY IS FEELING A SURGE FROM ITS ACQUISITIONS

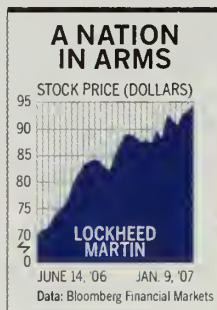
HOW THE THERMACOOL SKIN THERAPY FIRMS UP THERMAGE.

Lockheed: Rocketing Up

WORRIES THAT DEMOCRATS in Congress may roll back defense outlays doesn't faze fans of Lockheed Martin (LMT), the No. 1 maker of military weapons.

Although the Street has been cautious, with just 9 of 22 major analysts who track Lockheed bullish, the stock has rocketed from 72 in July to 94.66 on Jan. 10. One bull is Standard & Poor's Richard Tortoriello: The U.S. is "phasing out aging equipment," and Lockheed will benefit immensely, he says. Moreover, the threats from Iran and North Korea, plus the Iraq crisis, will make it tough to cut spending, he adds. The Defense Dept. has rejected plans of the Navy and Air Force to reduce the number of Lockheed F-35 Joint Strike Fighters they're buying.

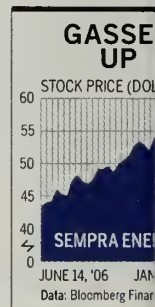
Lockheed primarily makes fighter planes, including the new F-35s that are to replace the aging planes such as F-16s. The F-35 program "will be the biggest, costing \$276 billion," says Tortoriello. Lockheed spokesman Tom Jurkowski says the F-35s will be operational, initially for the Marines, by 2012. Lockheed also makes space satellites, land-sea missiles, and electronic surveillance systems. "Lockheed's return on invested capital is solid," notes Tortoriello. It zoomed from 0.4% in 2000 to 17.5% in 2006. He sees earnings of \$5.50 a share for 2006 and \$5.75 in 2007. Goldman Sachs, which put Lockheed on its primary, "conviction" buy list, with a six-month target of 102, says the Defense budget for fiscal 2008 will boost the stock because it "will be favorable to Lockheed's programs."



Why Sempra Energy Is Electrified

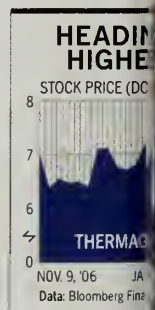
SEMPRE ENERGY (SRE) is a utility in motion: It's partly switching from a utility into an acquirer and developer of energy assets. And its stock is energized, climbing from 43 in mid-June to 55.64 on Jan. 10. Michael Heim of A.G. Edwards, which has done business with Sempra, rates it a "buy," with a 12-month target of 60, and he believes the makeover should push the price higher. Currently, the stock is trading below its peer group. But Heim sees forces that could further lift Sempra. It owns San Diego Gas & Electric, with 1.3 million customers, and Southern California Gas, a distributor, with 6.4 million. Its other operations are unregulated, including energy trading,

liquefied natural gas (LNG) terminals in North America, and gas pipelines and storage facilities in the U.S. and Mexico. Sempra may form a master limited partnership for these, he says. Paul Justice of Morningstar says: "We're particularly excited" by its entry into LNG and partnership with Kinder Morgan to build a pipeline from the Rockies to the Midwest. Both ventures should provide stable cash flow for years, he says.



Thermage's New Lift For Cosmetic Treatments

THERMAGE (THRM), a provider of noninvasive, tightening cosmetic treatments, has zigzagged since initial trading on Nov. 9 at 7 a share; it is now at 7. But some pros expect the stock will soar when Thermage's next-generation ThermoCool system is launched. CEO Stephen Fanning won't say exactly when the new version will come out, but he insists it will let cosmetic physicians deliver treatments much faster and more efficiently. With an O.I. from the Food & Drug Administration, ThermoCool, sold in 70 countries, uses a radio frequency (RF) generator that, through special tips, heats and shrinks collagen—tightening the epidermis and subcutaneous tissue—while cooling the skin's surface. The tips deliver the RF energy, cool the skin surface, and monitor skin temperature. Katherine Owen of Merrill Lynch, who rates Thermage a "buy," with a price target of 12, in a report describes the stock as a "pure play investment in the noninvasive aesthetic market." Key Nakae of C.E. Unte Towbin, also with a "buy," says the technology penetrates more deeply than laser and is better suited for other use as body shaping and contouring. One treatment lasts two to three years, he says. ■

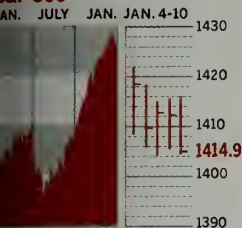


BusinessWeek .com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

STOCKS

S&P 500



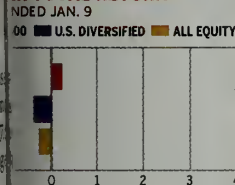
MENTARY

drooped a bit in the first full week of trading. Apple's shares rose on its introduction, that news too good for cell-phone Motorola, which fell. Goodyear Tire & Rubber after it settled its strike. This season also started to up: Sprint Nextel shares its 2007 sales forecast below expectations.

Source: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



4-WEEK TOTAL RETURN



Source: Standard & Poor's

THE WEEK AHEAD

CONSUMER PRICE INDEX

Friday, Jan. 17, 8:30 a.m. EST
Consumer prices are forecast to rise 0.5% in December, after a 0.2% surge in November. The consensus among economists surveyed by Action Economics. Minus food and energy, prices likely inched up following a 1.3% jump.

INDUSTRIAL PRODUCTION

Friday, Jan. 17, 9:15 a.m. EST
December factory output

U.S. MARKETS

	JAN. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1414.9	-0.1	-0.2	9.7
Dow Jones Industrials	12,442.2	-0.3	-0.2	13.0
NASDAQ Composite	2459.3	1.5	1.8	6.0
S&P MidCap 400	806.1	-0.1	0.2	4.5
S&P SmallCap 600	395.1	-1.0	-1.2	7.0
DJ Wilshire 5000	14,187.0	-0.1	-0.2	9.5

SECTORS

	JAN. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	796.3	0.3	-0.3	2.5
BW Info Tech 100**	446.4	-1.6	-0.2	11.0
S&P/Citigroup Growth	652.9	0.3	0.1	5.8
S&P/Citigroup Value	760.2	-0.5	-0.5	13.8
S&P Energy	421.8	-3.9	-7.4	5.7
S&P Financials	494.2	-0.5	-0.2	12.8
S&P REIT	200.9	1.0	1.0	23.3
S&P Transportation	260.2	-1.6	-1.4	4.6
S&P Utilities	183.7	-2.0	-1.6	12.9
GSTI Internet	201.2	0.4	0.7	-7.1
PSE Technology	898.7	2.6	2.7	2.0

*March 19, 1999=1000 **February 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	40.1	Steel	61.7
Real Estate Mgt. & Dvpt.	8.5	Tires & Rubber	40.0
Forest Products	7.0	Investmt. Bnkg. & Brkrge.	37.4
Computer Hardware	6.2	Broadcasting	37.2
Health-Care Supplies	5.4	Intgrd. Telecmm. Svcs.	35.6

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Pacific/Asia ex-Japan	4.4	Pacific/Asia ex-Japan	32.6
Diversified Pacific/Asia	1.0	Latin America	28.1
Technology	0.9	Europe	26.4
Japan	0.8	Real Estate	24.8
LAGGARDS		LAGGARDS	
Natural Resources	-7.3	Japan	-5.3
Precious Metals	-6.4	Natural Resources	1.0
Utilities	-2.1	Health	1.6
Small-cap Value	-1.2	Technology	2.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Dreyfus Prem. Grtr. China A	13.3	Dreyfus Prem. Grtr. China A	76.8
iShares FTSE Xha. Ch. 25 Idx.	10.3	Oberweis China Opport.	69.4
PowerShares Gldn Drgn China	10.0	Old Mut. Clay Finlay Ch. A	68.3
Matthews China	9.4	iShares FTSE Xha. Ch. 25 Idx.	64.5
LAGGARDS		LAGGARDS	
Dunham Real Estate Stock C	-21.1	Ameritor Investment	-85.7
Dunham Small Cap Value C	-17.0	DireXn. Emrg. Mkts. Short	-37.2
ProFunds Oil Equip., Svcs.	-16.0	Fidelity Japan Small Co.	-26.1
Dunham Emrg. Mkts. Stock C	-15.0	American Heritage Grth.	-25.0

GLOBAL MARKETS

	JAN. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1941.4	-3.5	-2.4	23.8
London (FT-SE 100)	6160.7	-2.5	-1.0	8.3
Paris (CAC 40)	5502.0	-1.9	-0.7	13.2
Frankfurt (DAX)	6566.6	-1.9	-0.5	19.5
Tokyo (NIKKEI 225)	16,942.4	-1.6	-1.6	5.1
Hong Kong (Hang Seng)	19,568.3	-4.1	-2.0	25.7
Toronto (S&P/TSX Composite)	12,457.6	-1.9	-3.5	7.4
Mexico City (IPC)	25,885.8	-2.8	-2.1	36.9

FUNDAMENTALS

	JAN. 9	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.79%	1.75%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.7	17.8	18.2
S&P 500 P/E Ratio (Next 12 mos.)*	14.7	15.4	15.0
First Call Earnings Surprise*	8.37%	8.10%	9.13%

*First Call Corp.

TECHNICAL INDICATORS

	JAN. 9	WEEK AGO	YEAR AGO
S&P 500 200-day average	1321.0	1318.3	Positive
Stocks above 200-day average	67.0%	74.0%	Neutral
Options: Put/call ratio	0.78	0.79	Positive
Insiders: Vickers NYSE Sell/buy ratio	6.41	6.47	Negative

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Coal	-19.6	Education Services	-35.0
Oil & Gas Equipment	-14.1	Homebuilding	-32.5
Oil & Gas Refining	-12.7	Gold Mining	-27.3
Steel	-12.4	Internet Software	-23.8
Oil & Gas Exploration	-11.6	Oil & Gas Refining	-19.9

INTEREST RATES

KEY RATES

	JAN. 10	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.87%	3.83%
90-Day Treasury Bills	5.09	5.05	4.29
2-Year Treasury Notes	4.81	4.76	4.40
10-Year Treasury Notes	4.69	4.66	4.43
30-Year Treasury Bonds	4.77	4.76	4.61
30-Year Fixed Mortgage†	6.02	6.04	6.08

†Barr's Mortgage

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10YR. BONO	30YR. BONO
General Obligations	3.77%	4.14%
Taxable Equivalent	5.39	5.91
Insured Revenue Bonds	3.94	4.44
Taxable Equivalent	5.63	6.34

probably rose 0.2% for a second straight month. The utilization rate very likely edged up to 81.9%, from 81.8% in November.
BEIGE BOOK Wednesday, Jan. 17, 2 p.m. EST » Federal Reserve releases its overview of economic conditions before the Jan. 31 monetary policy meeting. Economists fully expect the Fed to hold interest rates at 5.25%.

CONSUMER PRICE INDEX

Thursday, Jan. 18, 8:30 a.m. EST

» In December, consumer prices most likely increased 0.3%, after holding steady in November. Minus energy and food, the index probably climbed 0.2% after no change in the prior month.

RESIDENTIAL CONSTRUCTION

Thursday, Jan. 18, 8:30 a.m. EST » December housing starts probably eased to an annual rate of 1.55 million. Starts in November rebounded slightly, to an annual pace of 1.59 million.

The *BusinessWeek* production index improved to 286.2 for the week ended Dec. 30, a 6% increase from a year ago. Before calculation of the four-week moving average, the index eased to 289.3.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

It's about money.
Earning it.
Investing it.
Spending it.



Check out this weekend's show
January 13 and 14:

Consumer Electronics Show:
Content from media companies
is driving the introduction of
all-in-one tech devices.

Hottest Gadgets: The best new
offerings straight from CES.

Detroit Auto Show: Highlights
include latest models, concept
cars, and eco-friendly vehicles.

Car Shopping Online: Why
people use the Internet to
search, but buy on the lot.

Mutual Fund Scoreboard:
How to pick the right funds
for your portfolio.

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Open-Heart Nightmare

CORONARY A True Story of Medicine Gone Awry
 by Stephen Klaidman; Scribner; 303pp; \$25

In 2002 a Catholic priest named John Corapi had his heart checked out by Chae Hyun Moon. The celebrated cardiologist, who practiced at a Redding (Vt.) hospital owned by giant for-profit Tenet Healthcare Corp., responded to Corapi's symptoms of exhaustion and shortness of breath with five of the

most common words in the English language: "You need a triple bypass." The book begins the tale of the priest, the doctor, and the multibillion-dollar hospital chain recounted in penetrating detail in *Coronary: A True Story of Medicine Gone Awry*. Fortunately, as author Stephen Klaidman reports, Corapi then got opinions from three other doctors, all of whom said the priest was healthy since his arteries were completely healthy. The priest went home. An ensuing investigation and a series of civil lawsuits turned up more than 100 patients who were allegedly subjected to unnecessary heart procedures by Moon and his colleague, Dr. Fidel Realvasquez. The doctors, along with simultaneous revelations that Tenet may have improperly billed patients for as much as \$760 million a year, raised the question: what was the nation's second-largest hospital chain doing? And it provided forceful evidence that the drive for profits can put patients in mortal danger. Klaidman, an ex-reporter at *The New York Times* and *Washington Post* and a former health-policy researcher, intertwines elements of a medical mystery story with disturbing details about corporate greed. So profit-driven was Tenet, Klaidman discovered, that it required its hospital CFO to submit monthly reports on individual doctors' contributions to the bottom line. Redding Medical Center (RMC), home base to Moon and Realvasquez, was a money-making machine, generating \$3,181 in revenue per patient per day, or 10 times Tenet's average. What's more, in 2002 its pretax income was 11%, to \$93.6 million. Drawing on medical records, interviews, FBI files, and interviews, Klaidman brings this story to life, offering vivid dialogue and scene-setting. A novelist would be hard-pressed to invent more outrageous details. Colleagues and other doctors portray Moon and Realvasquez as egomaniacs who battled with each other and didn't win many friends among their patients, either. Realvasquez was so foul-mouthed that RMC's CEO felt he had to report him to Tenet's top brass. And more than

once, a nurse recalled, Moon rattled his terrified patients by remarking: "I'm going to save your life. This is your lucky day." Then there's the whistleblowing priest, whose story provides one of the book's most fascinating chapters. A former accountant and real estate broker, Corapi got caught up in the Los Angeles drug scene in the 1970s, even attending the party where comedian John Belushi was on the night he died. Homeless and strung out on cocaine, Corapi decided to turn his life around and entered the priesthood at age 37.

Equally compelling are Klaidman's stories of patients who weren't so lucky. There was the ex-railroad worker who had lost part of one leg in a boxcar accident and had to have a

vein taken from his good leg for a quadruple bypass. Then there was the grandmother who suffered debilitating strokes after her heart surgery. Later, physicians hired by a personal-injury lawyer determined that both patients' procedures were unnecessary.

In the midst of such gripping drama, Klaidman never forgets that, at its core, this is a tale of a company that seems to have cracked under pressure from Wall Street to continually boost profits. Just one day before the FBI raided RMC to collect evidence on Moon and Realvasquez, an analyst reported that Tenet had been raising prices in order to benefit from the extra fees Medicare paid for "outliers"—patients who have extraordinarily expensive procedures such as those performed by RMC's cardiac unit.

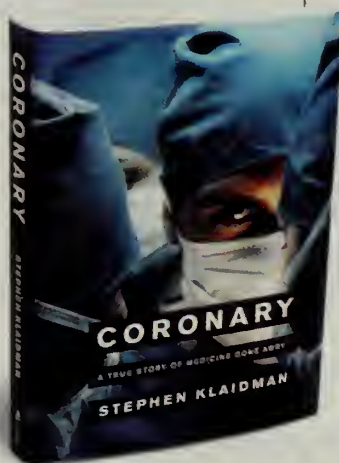
The coincidence is not lost on Klaidman: He says RMC was near the top of the list of outlier abusers, generating 59% of its pretax income from the fees.

Coronary's only failing may be the ending of its story. After hearing so many shocking tales, we expect the hand of justice to crush Moon and Realvasquez. In fact, the U.S. Justice Dept. did not bring criminal charges against the pair. They and Tenet settled the civil cases for \$450 million.

Moon and Realvasquez left medicine. Tenet also paid the U.S. government \$900 million to settle claims regarding alleged improper financial activities. The company, now a shadow of its former self, "has taken many steps to improve clinical quality and compliance oversight," says a Tenet spokesman.

Klaidman succeeds at casting a light on the all-too-frequent association of medicine and profit-mongering. And he leaves readers with a stark and enduring lesson: Never underestimate the importance of a second opinion. ■

—By Arlene Weintraub



A medical mystery—and a shocking account of corporate greed



IdeasOutsideShot

BY STEPHEN SLIVINSKI

Earmarking the Earmarks

The new Congress has agreed to take action on earmarks, the budget items better known as “pork projects.” Think, for instance, of the \$13.5 million that helped subsidize 2005’s World Toilet Summit in Northern Ireland, an expenditure worthy of jests about fiscal incontinence. In a mostly party-line 280-152 vote last week, the House passed changes to rules requiring

that both the spending projects and their sponsors be disclosed on the Internet at least 48 hours before they are considered on the floor. Members of Congress will also be required to justify the public need for the expenditures and to certify that they won’t benefit financially from them.

Nobody can really object to such a reform. It’s certainly a good idea to shed some light on what the now-convicted *über*-lobbyist Jack Abramoff once called the “favor factory.” But we should be realistic about what these reforms can achieve. Sadly, their impact is likely to be minimal.

For starters, some supporters of the change hope the number of egregious earmarks will decline because members of Congress will be too ashamed to attach their names to them. But as anyone who has driven over the Senator Robert C. Byrd Bridge knows, the problem isn’t that lawmakers don’t want their names affiliated with most earmarked projects. It’s that so many of them *do*.

In the past, the sponsors behind earmarked items remained anonymous, and it was possible for congressmen all to take credit for a single project. There was no official way to verify who was telling the truth. Now there is. Think of it as intellectual-property protection for government waste. And just as intellectual-property protection for inventions presumably creates an incentive to innovate, earmark transparency might also lead to a rise in the number and cost of earmarks.

BEFORE, YOU’D OFTEN be able to figure out which member of Congress was tied to what earmark. The 2005 Highway Bill, for instance, included specific earmarks for particular cities or roadways. Some line items in the bill went so far as to identify a specific highway exit number. Any savvy reporter sitting down with a road map and a congressional district map could discover who probably delivered the earmark. Yet even that fledgling form of transparency didn’t have an overall effect on the amount of pork in the bill. For instance, once the “Bridge

to Nowhere” in Alaska was exposed and soon became synonymous with wasteful road projects, representatives of the state—particularly Republican Senator Ted Stevens—never flagged in their support of it.

Even if transparency leads to fewer earmarks, there are no promises these projects won’t reappear in other ways or other places. The congressional budget process is nothing if not a game of reinvention. You could call spending it Happy Funtime Projects instead and sock them away in another part of the budget, but they will remain the cost of the realm on K Street.

Of course, Congress could simply give a bucket of money to an agency with no strings attached. But a member of the Appropriations Committee could write a letter to the department head suggesting something like: “Gee, wouldn’t it be nice if Project X got some of this pot of money?”

Can you really blame a government department head who reads a letter like that from a member of Congress who controls the budget and oversees his agency—and obviously would strike anyone in that position as silly? Tony Soprano saying to the corner grocery store owner: “Nice little place you got here. Don’t be ashamed if anything were to happen to it.”

So we probably won’t soon see an end to federal handouts, like the half-million dollars of taxpayer cash that in 2005 went to the Sp

Teapot Museum in North Carolina. Earmark transparency is merely a beginning. A good first step for sure, but here’s the endgame of fundamental budget reform. Indeed, reforms should create an incentive to reduce the scope of government overall. In the meantime, it’s important to remember that as long as a culture of spending persists in Washington—fueled by a budget process that allows Sam to be all things to all people—then no matter what power, earmarking in some form will always be with

Modest reforms won’t stop lawmakers eager to bring home the bacon

Views expressed in Outside Shot are solely those of contributors.

Stephen Slivinski, director of budget studies at the *Ca Institute*, is author of *Buck Wild: How Republicans Broke the Bank and Became the Party of Big Government*.

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

The Hot Buttons of 2006

WHEN WE STARTED THIS COLUMN A YEAR AGO, IT FELT A BIT like setting out on a journey without a map or destination. All we had to guide us, so to speak, was our collective experience and a real interest in answering questions about...well, whatever readers wanted to ask about. And ask they did. In 2006 this column received close to 10,000 e-mails from around the world with questions ranging from "Should I take a job at McKinsey or start a company doing something I really love?" to "Will the Chinese ever revalue their currency to reflect its real strength?"

But if the breadth of questions surprised us, we were even more taken aback by the impassioned reaction to some of our answers. Yes, some columns came and went without much noise. But many—four in particular—sparked exceptional sound and fury. And so before launching into another year of questions and answers, we'd like to take a look back at the tallest lightning rods of the one just past.

First, our column "What's Holding Women Back" made the case that the relatively small number of women CEOs today was not, generally speaking, the result of a cabal of sexist male executives but of biology—or put more bluntly, babies. Not that working mothers can't function; many never miss a beat. But many others intentionally remove themselves from the corporate escalator to spend more time at home. Thus, we said, there's no villain in this situation, only the reality that sometimes life requires tough choices, and with those choices, an acceptance of their personal or career consequences.

But not if you're a man, many readers quickly retorted. In fact, many of the e-mails about this column argued that there would be more women CEOs if husbands simply shared child-rearing responsibilities. Still others asserted that the problem lies not with errant husbands but with the male power Establishment, which persists in valuing exactly what working mothers are most hard-pressed to deliver: availability. "The system is rigged against women," one reader wrote. "You let it off too easy."

EMOTIONS ALSO RAN HIGH about our column "Are You a Boss Hater?" in which a reader asked why, in his long career, he had never encountered a manager he could respect. Our reply: Maybe you are just one of those diehards who constitutionally hates people in positions of authority.

Within hours our mailbox was filled with thank-you notes, mainly from managers who had struggled with "boss haters"

and were relieved to hear that the ire directed toward them was more ideological than personal. We also heard from people who identified themselves as "reformed" boss haters or as one reader said, "I (secretly) criticized management until I was made a manager myself...and I realized most everything they did made sense in context." Still, the bulk of the responses to this column came from readers who basically said: "You must live in a bubble. Most managers are self-serving, incompetent idiots, and your so-called haters are the only ones out there with the guts to say so."

We were also accused of living in a fantasy world by a majority of respondents to our column on human resources departments, "So Many CEOs Get This Wrong." Yes, HR has its proponents; some even wrote in to support our assertion that HR should play an active and vital role in building teams. But most of our mail sounded like the letter from the CEO of a small company in New York who wrote: "What are these insightful, savvy, talented HR people you refer to?"

Have them at the table, making decisions with the CFO and me—if they existed. The truth is, most HR people are only capable of filling out benefits forms and running picnics. That's why they're marginalized."

But nothing, in terms of volume and intensity, compares with the response we received to our column "What's Right About Wal-Mart." At first, we were stunned to see so many people—about 80%—agreed with us. Wal-Mart does more good for the economic society than most government institutions. But after a few days passed, the tone changed and you would have thought we'd called for the canonization of Osama bin Laden. Hundreds of messages accused us of hating labor, poor

people, and small business. As one reader wrote: "Wal-Mart destroys freedom and the American dream. What were we thinking?"

Well, not that! But we were also thinking, isn't this the Every heartfelt question we've received and every past response to our answers has not only helped us crystallize our own views but helped us discover what excited, and inspired, people in business in 2006.

Will 2007 bring more of the same or a whole new set of issues? We look forward to finding out—from you. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast, go to www.businessweek.com/search/podcasting.htm.

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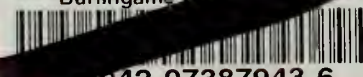
Business Week

7 January 29



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Imagine a world

in which socially responsible and eco-friendly practices actually boost a company's bottom line. It's closer than you think. **BY PETE ENGARDIO (P.50)**



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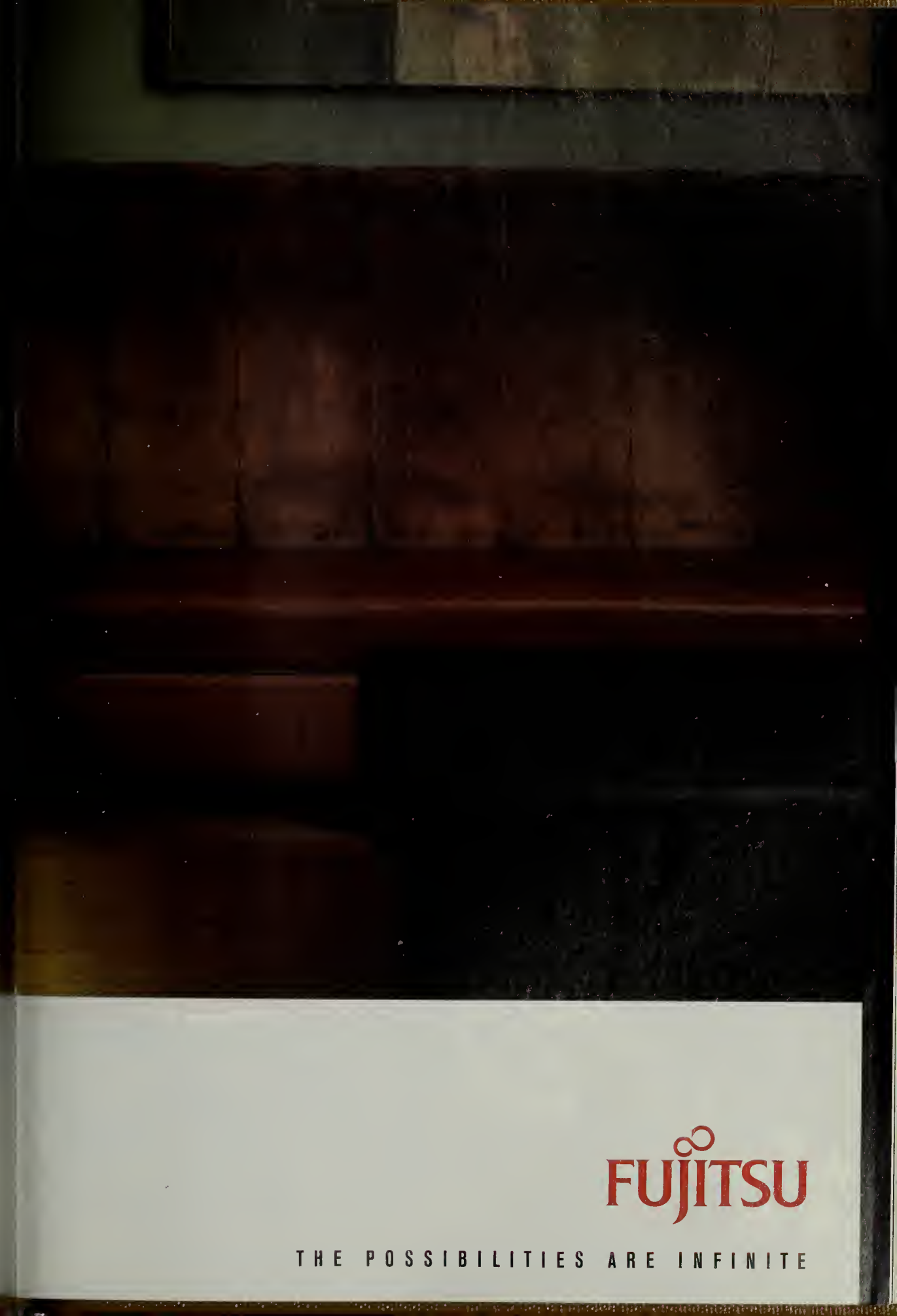
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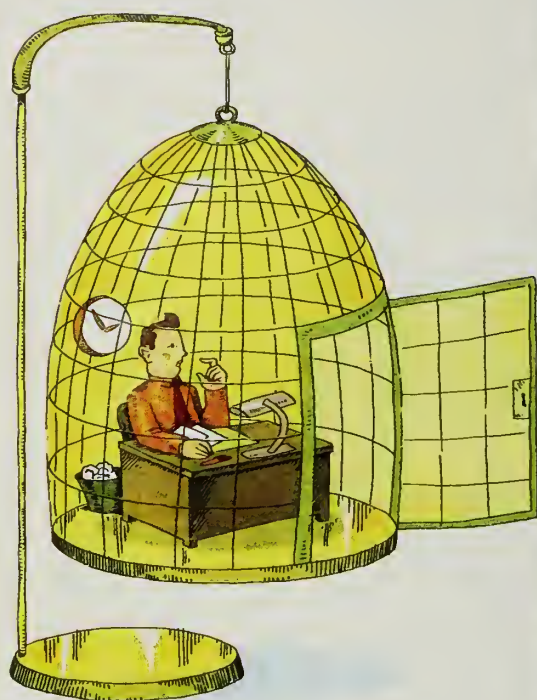


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NEW GOOD DEAS



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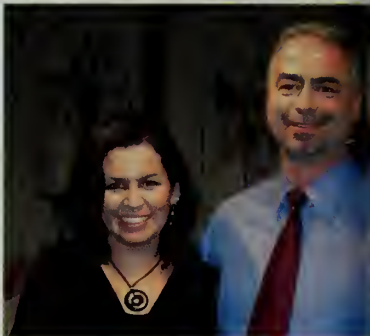


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Ready for Your Second Act

Why sit tight in Corporate America? For many workers, reduced job security and dwindling benefits are reasons enough to open their own shops. Our **BusinessWeek.com Special Report** examines the trends and profiles people who have veered off traditional career paths to start their own ventures. Consider rock group **Gang of Four's Dave Allen**, who launched a record label that lets artists keep the rights to their music. Or **Roxanne Quimby**, who is gearing up for three new startups after selling her personal care products business, Burt's Bees. Also check out the recent minted entrepreneurs whose businesses are breaking through the \$1 million threshold. And for those still in their day jobs, there are **tips and free resources** available, including a quiz that will help you know if you're ready. Finally, a **podcast** with Jeff Williams, whose latest startup specializes in helping people 50 and older start their own businesses, offers some candid advice. Go to www.businessweek.com/go/07/secondacts for all this and more.

BusinessWeek weekend

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"Programming Chief." Seattle, WA.
Image courtesy of the human network.

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A STAR ALLIANCE MEMBER

UP Front

"I can look back and say, of course, there were things I would do differently."

—BP CEO John Browne, who will step down at the end of July—a year earlier than planned—reacting to a report linking BP's lack of emphasis on process safety to its deadly Texas refinery blast in 2005

ED BY DEBORAH STEAD



the sale of
ar brought
his stake
Disney

NEYLAND

Why Steve Loves Mickey

may be facing scrutiny from the SEC
Justice Dept. for backdating options.

CEO Steve Jobs is getting
ing but good news from
er one of his holdings.

Walt Disney's largest
ual shareholder. Since
se of the sale last May
majority-controlled
Animation Studios to
ry for Disney stock, the
of his 6.7% stake in the
giant has grown by
e \$1 billion.

A few weeks ago, Disney
hrew in a little
ag-around money,
ing a 31¢-a-share
nd that gave him \$43 million more.
Jobs's stake in Disney is now worth
9 billion, far exceeding his \$955.6
in stake in the computer company he
founded.



JOBS

None of this is likely to change Jobs's
mindset at the office. At **Apple**, he famously
takes only \$1 a year in salary
and hasn't received stock
options since 2001, although
he has received a substantial
share grant. At Disney,
according to the company's
Jan. 12 proxy filing, he has
declined the \$65,000 annual
retainer, the stock options,
and the \$60,000 in stock
grants that Disney awarded
last year to each board
member.

No word yet on whether
Jobs, a father of four, will
accept a different kind of
annual perk from the company: \$15,000
worth of Disney treats—from free theme
park tickets and cruises to Mickey Mouse
tchotchkes.

—Ronald Grover and Peter Burrows

THE BIG PICTURE THE PROMISES CITIES HAVE TO KEEP

Two reports by Moody's
Investors Service show just how
high retiree costs have become
for big municipal employers. The
health-care and pension payouts
for retired police, teachers,
and other workers are two of
the fastest-growing expenses
for cities, Moody says—and an
increasing focus for the financial
firms that analyze and invest in
their debt. Only about 60% of the
cities surveyed have the funds
to cover 80% or more of their
retiree obligations.

Retiree costs as a
percentage of annual
municipal operating funds:

DETROIT

18% (\$311 million
annually)

TAMPA

17% (\$58 million
annually)

ATLANTA

15% (\$69 million
annually)

NEW YORK

8% (\$3.8 billion
annually)



Data: Moody's Investors Service, BusinessWeek

NEW MATH

WE'LL GET AROUND TO IT LATER

The proof is in: Almost everyone procrastinates. Looking at every procrastination study he could find, Piers Steel, a human resources professor at the University of Calgary's Haskayne School of Business, has concluded that about 95% of us procrastinate at times, with 15% to 20% being chronic offenders.

Behind all the dilly-dallying is lack of confidence about finishing the job, boredom with the task, and a human



tendency to go for immediate reward over long-term gain. Steel even came up with an equation:

$$\text{Utility} = E \times V/A \times D.$$

"Utility" stands for attraction to the task, which depends on a combination of one's expectation of finishing it (E), the value in completing it (V), the task's immediacy (A) and one's distractibility (D). "Anything that offers a distant reward for immediate effort, especially if we find the effort boring, we will put off," Steel says. A common play for avoiding work at the office, he says—reading each e-mail as it comes in.

—Catherine Arnst



INDY

Once again the track is a showcase for new technology

FUTURE CARS

BURNING HYDROGEN AT THE BRICKYARD?

THE BETTING odds in the auto biz are that hydrogen fuel cell cars won't be ready for the roadways in real numbers until the next decade. But a few of them might be racing around the Indianapolis Motor Speedway in just two years. Peter DeLorenzo, publisher of gadfly Web site Autoextremist.com, is trying to put together the Hydrogen 500, a fuel-cell car race at Indy by 2009.

If DeLorenzo pulls it off, Americans would see a real-life demo of cars running on fuel cells—which strip electrons from hydrogen to power electric motors. Race teams, driving the cars at speeds of up to 180 miles per hour, would have to keep the nascent technology going for the full 500 miles. The race would serve as a live test lab for a technology that many

see as the next leap in powering automobiles. The 500 used to be a place to showcase new technology (including when it was an innovation in the rearview mirror) racing leagues mandate every car meet strict specifications.

There is some support for DeLorenzo's idea. He pitched it at a meeting in Detroit and got the ear of executive nearly every major car company, including GM Vice-Chairman Robert Lutz. But cost is an issue. One GM insider would take "tens of millions" to run this race. Hey, the race isn't cheap. —David

PRICE MAIZE

TORTILLA TROUBLE IN MEXICO

IS SURGING demand for ethanol helping to create a tortilla crunch south of the border? Mexican consumers, particularly the poor, have been complaining loudly over tortilla prices, which are up as much as 60% since January, 2006. Mexico's Banco de México has charged dominant local corn flour suppliers to

tortilla makers with price manipulation. In response, the industry blames high energy prices and corn shortages caused by the U.S.'s recent hunger for ethanol.

Critics of the corn flour oligarchs, though, point out that ethanol comes from

yellow corn—not the white variety that generally goes into tortillas. The ethanol industry, they say, is being used as a pretext to raise white corn prices.

Speculation may be a factor. But the government has helped create a shortage by exporting precious white corn and encouraging farmers to use it as feed.

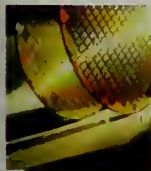
As producers and consumers argue, Mexico has placed an order for 650,000 metric tons of corn to drive down tortilla prices. More than half will be corn imported from the U.S.

—Eliza B.





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TEED OFF

CLINT'S OTHER BEACHHEAD DRAMA

CLINT EASTWOOD climbed Mt. Suribachi twice last year with his World War II flicks, *Flags of Our Fathers* and *Letters from Iwo Jima* (which just won a Golden Globe Award for Best Foreign-Language Film). He's having a harder time on the shoals of Monterey Bay. Eastwood is part owner of the storied **Pebble Beach** (Calif.) resort, which has been trying for years to expand its facilities and add a fifth golf course.

Since Eastwood's local TV appeals helped push through an initiative for the expansion in 2000, the \$200 million project has been stalled by regulatory



EASTWOOD

problems. Last year, staff members of the **California Coastal Commission**, which oversees shoreline construction, recommended that commissioners vote against the plan.

Alan Williams, project manager at Pebble Beach, says he has already cut the number of houses from 890 to 38 and is shortening the driving range and moving the equestrian center to try to save one-third of the 17,000 Monterey Pine trees threatened by the project. The commission could vote in March on zoning for a project go-ahead, says Mark Stilwell, Pebble Beach's general counsel. That still won't put Eastwood and his partners in the clear: Environmentalists say they'll sue if the plans are approved.

—Christopher Palmeri



BALING OUT

AS LANDFILLS overflow and garbage mu carted ever farther afield, a system devised by Transload America in South Orange, N.J. is handling some of nearby Long Island's trash in a fresh way. It creates cylindrical bales that cram everything from food scraps to construction debris into a fourth of the original volume. **The system shreds and squeezes garbage, then rolls it up like a sleeping bag before shrink-wrapping it to be hauled away by truck or train.** Transload says it's the first outfit in the U.S. to create cylindrical bales, which are used more widely in Europe. "Traditional square bales tend to retain fluid in the corners, which makes them heavier," says CEO David Stoller, "and prone to leaks and smells."

—Aili McCon

BLOGSPOTTING

OFF THE E-SHELF 800ceoread.com/blog

» **FANS OF** management gurus such as Peter Drucker and Tom Peters should check out this daily blog, a feature of 800 CEO Read, an online bookstore with 10,000 corporate and organizational customers, including B-schools. Entries range from excerpts (*The Executive Almanac* is currently featured) to assorted factoids like the average age of U.S. car owners (62 for Buicks, 41 for Volkswagens). Authors' podcasts are also available, along with the parent site's best-seller list. Among today's chart toppers? *The Houdini Solution* and *Why You're Dumb, Sick & Broke...and How to Get Smart, Healthy & Rich!*

—Lindsey Gerdes



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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

When It's Time to Fire the Boss

How does a board of directors go about firing a CEO or persuading him to step down? It's a question I'm asked more often, as CEO turnover increases—in part because of greater board accountability—and as abrupt departures, like that of Robert Nardelli of Home Depot, are in the news.

WHEN DIRECTORS call me in to help figure out if, and how, they should remove a chief executive, they typically need the most help in dealing with their attachment to the CEO. Some directors have friendships with him. Others identify with him, as CEOs themselves. Still others can't admit they might have been mistaken when they supported (or even hired) him. This isn't true in all cases. But in my experience, it can take months of moving through denial, guilt, and anxiety before there's agreement that the boss has to go.

The process at one company I advised is a case in point. Since the CEO had been hired a few years earlier, share prices had been flat. But the stock wasn't the big problem: He was a disaster as a manager, abusing senior executives to the point where several excellent top execs had quit, putting the business strategy in disarray as well. Several of the directors, though, had helped pick him



and treated him like a favorite son. So when I presented my frank assessment of the CEO and his troubled team dynamics, as asked, they hesitated to accept it.

As I met with them, I raised the possibility that this might stem from a reluctance to admit that they hadn't done due diligence about the CEO's personality when they hired him. (I've found that interpersonal skills and cultural fit often don't get enough weight when boards hire a new CEO. But that's another column.) Seeing the truth amounted to admitting their own failure, not just the CEO's. Their egos required some soothing before they could take the right action—and spare their CEO unnecessary humiliation.

They felt guilty, as well, having to ax someone they were accustomed to supporting.

I SPENT a lot of time discussing all this one on one with the chairman and directors by talking to the entire board crucial to get complete buy-in. When the board finally decided to terminate the CEO, the further debates about what to say (the language we used)

left no room for negotiating the decision helped the CEO save face) and who should say it (the chairman and a director who close to the CEO delivered the news to). More anxious discussions followed—to anticipate damage in the press and minimize business disruption. The entire ordeal took an emotionally draining three months. But once the CEO was gone, there was a sense of liberation. The intense focus ended. People got back to work.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send questions at analyzeethis@businessweek.com.

QUESTION OF THE WEEK

House Speaker Nancy Pelosi (D-Calif.) says that her parenting skills have helped her succeed in her career. Is that your own experience?

"Parenting skills ARE leadership skills. You have to make decisions and stick to them, have patience and a sense of humor, and find some fun in what you're doing."

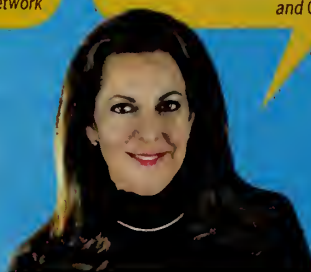
Debra Lee, Chairman and CEO, Black Entertainment Network

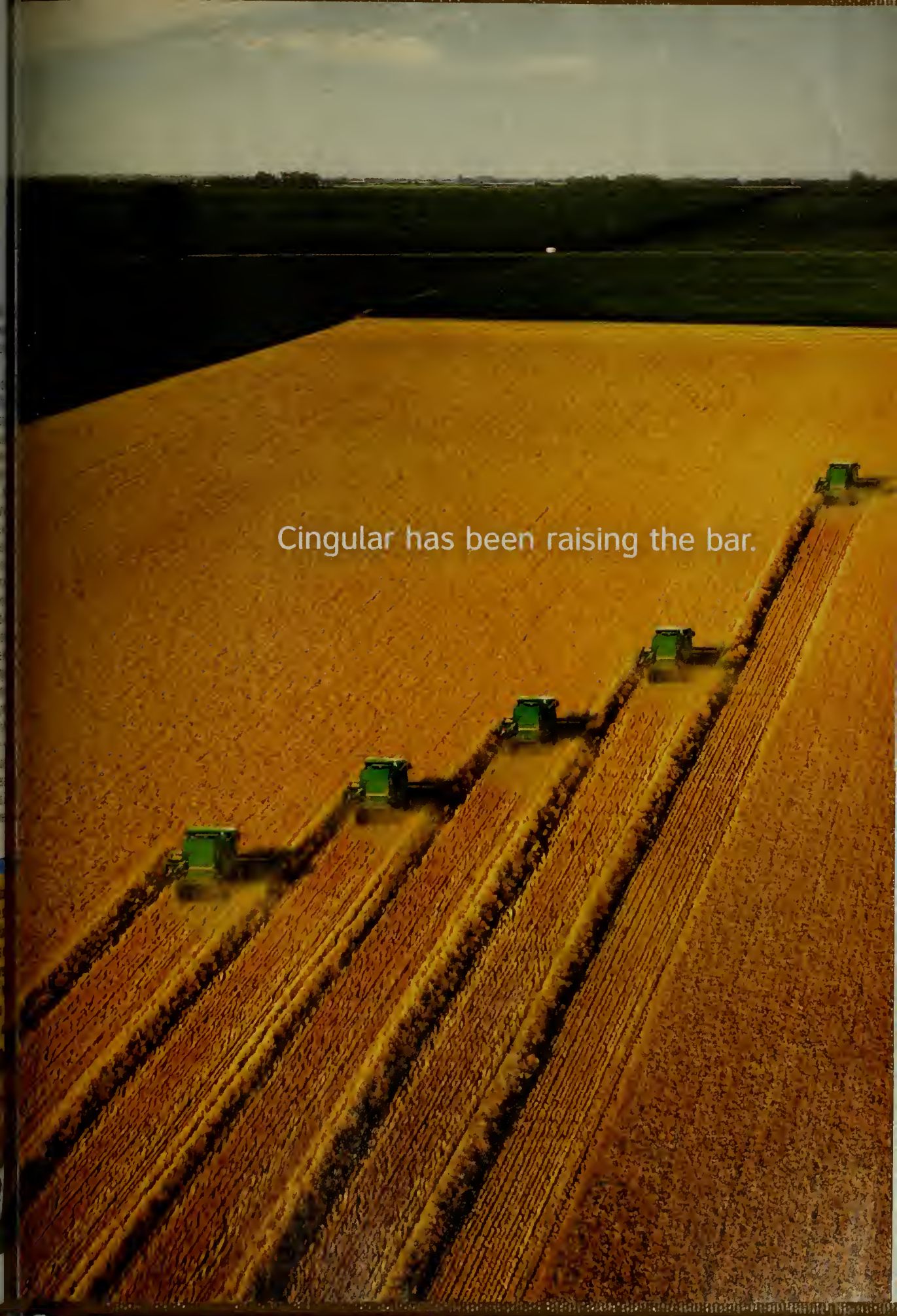
"I nurture my two children based on their unique differences and strengths. I try to develop employees using the same approach—helping them capitalize on their distinct qualities."

Julia Stewart, Chairman and CEO, IHOP

"Being a parent is tougher than work, and the standards are much higher. Having five children keeps you humble. Kids also remind you that no matter how many mistakes you make, the key is to keep showing up."

Stephen Burke, President, Comcast Cable





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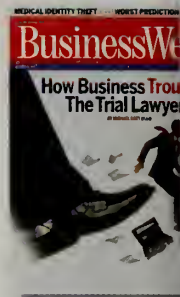
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“Tort reform...is not a battle between trial lawyers and business, but rather a battle between consumers and business.”

—Andrew M. Abraham
Boston



THE TRIAL LAWYERS AREN'T CRYING UNCLE

“HOW BUSINESS TROUNCED the trial lawyers” (Cover Story, Jan. 8) fails to properly acknowledge the devastating impact that the assault on the nation’s court system has had on the American public.

Many victims can no longer hold wrongdoers accountable for negligence, get the truth about how their injuries occurred, or be assured that the negligent corporation will change its ways to avoid similar incidents in the future. And in many cases, a key incentive for corporate responsibility has been dismantled.

Proponents of civil justice restrictions have spent billions on their misinformation campaign spreading nonsense that individuals seeking justice through the courts are destroying the economy, flooding the landscape with frivolous lawsuits, and undermining corporate largesse. No evidence exists to support any of these scurrilous claims. The article suggests the battle is over. Far from it.

—Jon Haber
Chief Executive Officer
American Association for Justice
Washington, D.C.

THE TITLE OF your article misses fundamental point in the tort reform battle: It is not a battle between lawyers and business but rather a battle between consumers and business.

It is a fundamental American principle that corporations should be accountable to consumers for mistakes; our justice system used to enforce that. The insurance industry and large corporations have engaged in a prolonged, and, as your article correctly points out, largely victorious assault against this bedrock principle. Calling it tort reform and using trial lawyers as a punch bag is an effective marketing strategy that obscures the reality.

Our civil justice system is supposed to make businesses act responsibly by ensuring that they are accountable. By keeping businesses on their toes, the consumer wins. The immunity of tort reform leads to cutting corners and hiding the damage some products pose. The next time you run this article entitle it: “How Big Business Trowned the American Consumer.”

—Andrew M. Abraham
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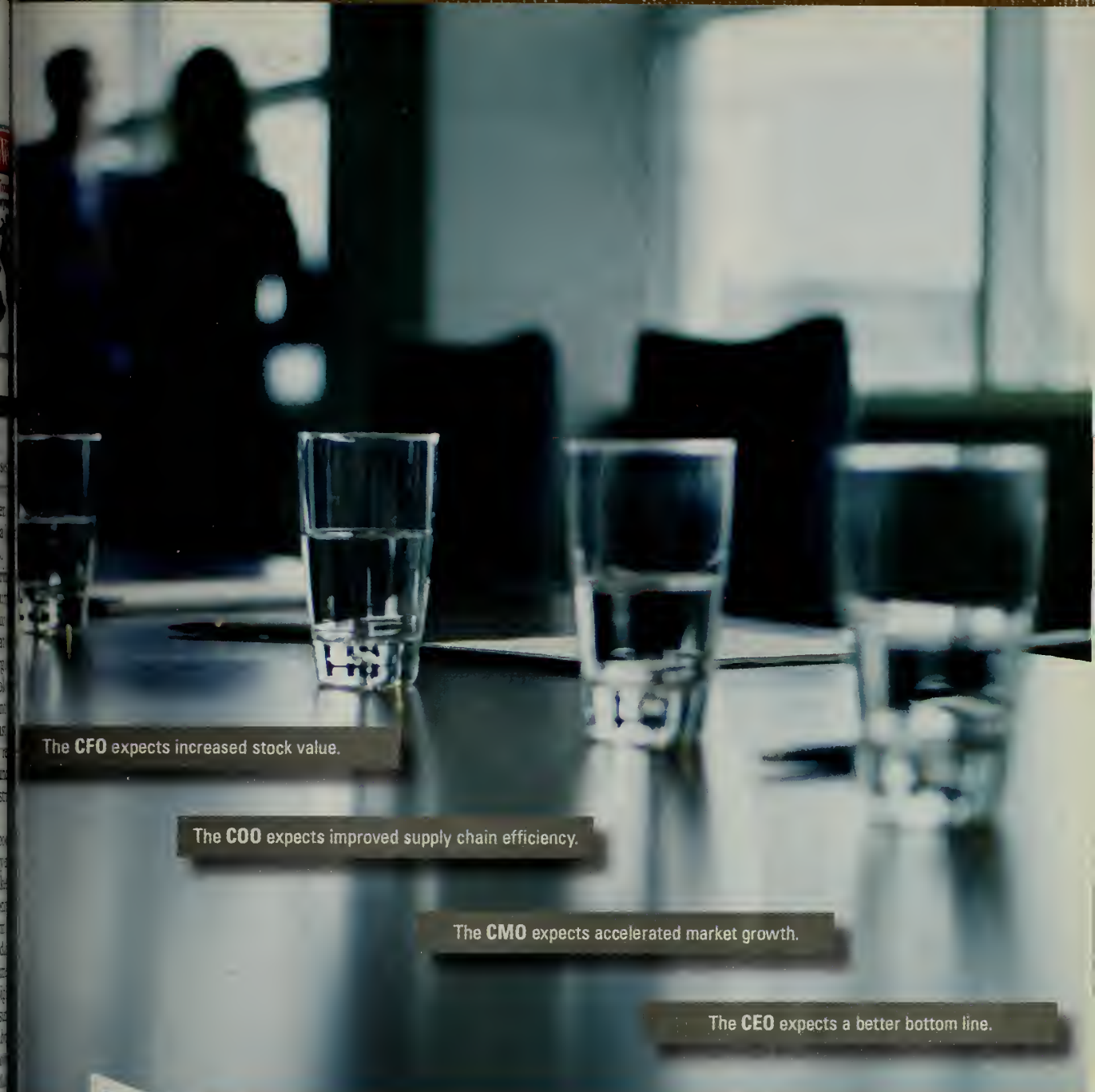
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CLAIM THAT the trial lawyers "have been trounced" is part of a strategy perfected by the ancient Greeks. The Trojans might say the story. We hope the business community will not.

The plaintiff trial lawyers are the most disciplined and richly funded special interest group in this country. They will remain a threat to the civil justice system—and elsewhere—as long as there is money in the lawsuit business.

Texas has reformed its laws, but attempts to "loophole" the reforms continue, especially forum-shopping strategies seeking venue in one of several Texas counties where lawyers, judges, and juries are notoriously open to manipulation. The counties not only victimize any business or individual unlucky enough to be dragged into their courtrooms; they also degrade local economies and erode public trust in the civil justice system.

—Hugh Rice Kelly
General Counsel

Texans for Lawsuit Reform
Houston

HEALTH CARE: WE'RE PAYING MORE, BUT ARE WE GETTING MORE?

ALTHOUGH OTHERWISE INTRIGUING, John Hofman's "A Medicare intervention" (Outside Shot, Jan. 8) suffers from a gaping miscue that Economics 101 attempts to forestall. When a society becomes willing to pay more for something, the quantity sometimes gets more of it. But the result is hardly an economic truism. The more plausible result is in which society spends more only to end up getting the same amount, as when unit prices rise without affecting the available quantity. The unavoidable confusion about such demand and supply elasticities has plagued the health-care debate, to say nothing of befuddling freshman economics students.

—Thomas D. Hopkins

Professor of Economics
Rochester Institute of Technology
Rochester, N.Y.

TRAVELING THE MULTIPLE PATHS OF ALZHEIMER'S

"CODING ALZHEIMER'S" (Special Report, Jan. 8) is a good first step toward untangling some of the complexities of Alzheimer's research. Unfortunately, you focus on Alzheimer's as a single disease and didn't address the growing understanding among researchers that it may be multiple diseases with multiple causes. Further strides toward understanding, preventing, and treating this class of devastating illnesses will be made as better knowledge of those multiple causes

is gained. This approach will enable physicians to better diagnose subtypes of Alzheimer's and to prescribe treatments based on that individualized diagnosis.

—Mona Johnson
Largo, Fla.

NOT EVERYONE WHO TAKES HERBAL REMEDIES ENDS UP IN THE ER

SCIENCE IS VIRTUALLY absent in *Natural Causes*, reviewed in "Modern snake oil?" (Books, Jan. 8). The author instead relies primarily on fantastic isolated incidents to falsely imply these tragic cases represent the experience of more than 150 million health-conscious Americans who take safe, beneficial dietary supplements every year. This safety record is the result of conscientious producers and manufacturers, coupled with appropriate regulation by the FDA.

In an attempt to sell books, the author cobbled together personal opinion and selective interpretation of events and regulatory history. *BusinessWeek* owes its readers greater due diligence.

—Steve Mister
President and CEO
Council for Responsible Nutrition
Washington, D.C.

CORRECTIONS & CLARIFICATIONS

"Decoding Alzheimer's" (Special Report, Jan. 8) misspelled the names of Dr. Howard Fillit, director of the Institute for the Study of Aging, and Illana Gozes of Tel Aviv University.

"What happens to that scarf you really hated" (News & Insights, Jan. 15) should have said that Genco began processing returns for Wal-Mart in 1992, not 1993, and that it had previously worked with Target.

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Easy Ways to Find Your Way

When driving directions from MapQuest first became available a few years ago, I stopped relying on traditional maps and started traveling with a briefcase stuffed with printouts of routes. Now I rarely leave home without some sort of navigation device. They have gotten good enough—and cheap enough—that there's really no reason to go without.

The best navigation systems are the ones installed in cars, but they have three disadvantages. First, there's cost: The excellent system in the Acura TL, for example, adds \$2,000 to the price of the car. Second, you may want a system but not a new car. Finally, you won't have built-in navigation when you're most likely to need it: driving a rental in an unfamiliar city.

Add-on systems basically divide into phone handsets and dedicated navigation devices. Handsets from Verizon Wireless, Sprint, Nextel, and Alltel include global positioning system (GPS) circuitry and offer services that provide maps and navigation information on the phone. (Phones from Cingular and T-Mobile, which use a different technology, require a much less convenient external GPS receiver, usually connected through Bluetooth wireless.)

I TRIED VERIZON'S VZ NAVIGATOR (a \$10-a-month service provided by startup Networks in Motion), which is available on many high-end Verizon handsets. You can mount the phone on the dash or windshield with a bracket, but I found it worked fine just propped up in what used to be called the ashtray. While the map on the small display wasn't really big enough to glance at while driving, listening to spoken directions through the phone's speaker or a headset proved perfectly acceptable. The timing of turn instructions was accurate, and the service quickly recalculated the route if I went off-course. Because it's just the handset you'd carry anyway, it's also great for use on foot. The service would be even more useful if it came with a pedestrian mode that ignores traffic restrictions such as one-way streets.

People who prefer the alternative—dedicated navigation devices—will be pleased to know that several manufacturers are in a price war. So you can get good value for \$200 or less. These gizmos typically come preloaded with maps and offer a 3- to 4-in. touch-sensitive display you mount on a windshield or dashboard. Some high-end models add real-time traffic reports as an extra-cost option, though in most U.S. cities the information is too sketchy to help much. Just about all of these



**VZ NAVIGATOR
ON AN LG VX9800**

products use the same SIRF Technology GPS chips and NAVTEQ TeleAtlas maps, so there's little difference in performance among them. Products from Pharos, TomTom, Magellan, Navman, Pioneer, Mio, and others will all do the job.

The Pharos GPS135 I tried has a clunky user interface, but at just under \$200 it's a good buy. At the higher end, the Garmin Nüvi 350 remains a personal favorite. It's compact enough to slip into a pocket and is very easy to use. Because of the turn-

in the market, you can easily find it for \$200 less than its \$642 price.

Almost any Palm or Pocket PC can become a navigation device with added software and a Bluetooth GPS receiver, but these two-piece solutions are clunky. Although a PDA with navigation built in seems like a natural, the idea has never really caught on. The latest entry is Hewlett-Packard's iPAQ rx5900 Travel Companion, which is

Navigation devices cost less now, and cell-phone services work almost as well

car-mountable navigation tool and a full-featured Windows Mobile PDA. But it's fairly bulky, costs over \$550, and belongs to the fast-declining class of PDAs without built-in phones.

For light duty, a navigation handset—a new cell phone, in other words—may be the best bet. It saves you from adding another gadget to your life, though the monthly charges can get annoying. If you want to take a step up, there's a dedicated GPS navigator for just about any budget. ■

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Yahoo's Unlikely Amigos

Evidently the newspapers are going to try to partner their way out of it. In this case, "it" is whatever disadvantages the medium faces in the online world. And sliding revenues, reported by major newspaper companies in the last half of 2006. And those companies' steep stock price declines. A nine-company consortium representing more than 215 U.S. dailies has

already signed on with Yahoo!—itself no stranger to share price slippage of late—to partner with Yahoo HotJobs in an online classifieds venture. This consortium, including the likes of E.W. Scripps (which is mulling what it may do with its newspapers), Hearst Newspapers, and MediaNews Group, is in a 90-day exclusive negotiating period with the online giant over at least five key areas to broaden the partnership. (More on this later.) And the three companies behind the online help-wanted classifieds site careerbuilder.com—Gannett, McClatchy, and Tribune—are discussing an alliance to create an online ad network.

Both groups welcome other partners, but the Yahoo partnership has had better luck in scoring them so far. Morris Communications and Media General have signed on since the HotJobs deal was announced. New York Times Co. and the newspaper division of Advance Publications (which also owns the glossy magazine world's Condé Nast Publications) are discussing joining up as well, say executives familiar with the matter. (A Tribune spokesman said other unspecified companies are considering joining its partnership.)

The Yahoo partnership has a weakness for wacky monikers. The online giant and its "Nine Amigos" have assigned at least five "tiger teams" to explore relationships with Yahoo. Among them: extending distribution of Amigos news stories with Yahoo, including spotlighting them in search results; turning over Amigos site-search engines to Yahoo and creating co-branded search toolbars; finding ways to integrate Yahoo's local search with newspapers' data; having newspaper sales staffs sell Yahoo ads to local advertisers and having Yahoo staff sell national ads for the Amigos sites; and allowing the Amigos Web sites to use Yahoo's ad technology.

You can argue that newspapers are dealing with a sworn enemy here, but the reality is more nuanced. The big online players have a horrible record in tailoring products to local markets. In the mid-1990s, Microsoft planned a local city



guide called Sidewalk. There was wailing and gnashing of teeth among newspaper executives, who feared the well-heeled newcomer would crush them. But the service never grabbed substantial share, and Microsoft sold it in 1999. Meanwhile, it's not hard to find examples of some newspaper companies welcoming arrangements that were once deemed unthinkable. MediaNews Group, which publishes more than 50 papers including *The Denver Post* and *San Jose Mercury News*, will soon open a combined print and online national sales office in New York—and is currently discussing involving Yahoo, as well.

Why the portal and newspapers find they're joined at the hip

Once again, souring reversal scenarios—for both Yahoo and newspaper companies—spurs creativity. Yahoo seeks a fix appropriate to its content-centric ways, which persist even after a key architect of its media ambitions, Lloyd Braun, departed last year. The world's No. 1 portal is betting that, like Microsoft, it can't do local by itself. It's also betting there is a huge upside in the local space for the kinds of display ads which it still outshines Google. And it's a nod to the reality that advertisers remain more comfortable having their ads around tamer and more traditional media rather than, say, user-generated videos. (Sighted at long last: the commercial advantage to the bland-ing-out of the local paper.) As for newspapers, nuances aside, they are dealing with the king company—online, and measuring profit by the billion—the one they once feared. But these days, they fear reality more.

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AMES C. COOPER

A Surprise Pickup With Room to Run

Consumer spending and cheaper oil are fueling a bonanza few saw coming

U.S. ECONOMY Is the slowdown over? It's starting to look that way. Last quarter the economy appears to have outperformed expectations most forecasters held only a few weeks ago. In early December, a *BusinessWeek* survey showed that, on average, economists believed growth in the fourth quarter would post another

showing to match the third quarter's 2% advance. Given the surprising strength in a number of indicators, including retail sales, industrial production, jobs, and foreign trade, many analysts think the economy is regaining some momentum that will carry it into 2007. Further declines in energy prices in early 2007 will only add to the forward thrust.

The first official word on the economy's overall performance in the fourth quarter will come on Jan. 31, when the Bureau of Economic Analysis reports its first estimate of the quarter's growth in real gross domestic product. Many economists now believe real GDP grew in the not-too-shabby neighborhood of 3% last quarter, and, importantly, the mix of pluses and minuses among GDP's various components will point to continued healthy growth in the first quarter as well.

This runs counter to fears that last year's excessive slowing in growth—from 5.6% in the third quarter to 2.6% in the second quarter and 2% in the third—was a precursor to an extended period of recession, or even recession, fueled by the slump in housing and a buildup of excess inventories across a wide array of goods. The fourth-quarter GDP report offers the strongest evidence yet that the housing downturn is an isolated event and that any inventory glut is capable of depressing growth in early 2007 is on its way to being eliminated.

MAPS THE MOST IMPORTANT trend to note in the latest GDP data is the diverging patterns of housing and consumer spending. In the second half of 2006, as residential investment was falling at an increasingly rapid rate, consumer spending was actually accelerating. Based on monthly reports through November, residential investment in the fourth quarter appears to have declined at an even greater rate than the third quarter's 18.6% plunge, which followed an 11.1% drop in the second quarter. Last quarter's drop will most likely subtract more than a percentage point from overall GDP growth, which would be the biggest quarterly drag due to a component since the 1981-82 recession. At the same time, the data on retail sales imply

consumer spending grew in the range of 4% to 4.5%, a sharp advance on the third quarter's 2.8% increase, which was a shade faster than the second quarter's rise. Consumers contributed close to three percentage points to GDP growth last quarter, the kind of boost seen in a boom, not a slowdown. So much for the notion that the housing decline is dragging consumers down.

Consumers will still have plenty of wind in their sails heading into the first quarter. Solid back-to-back gains in retail sales in November and December—0.6% and 0.9%, respectively—show a rising trajectory, especially when the ups and downs caused by gas prices are excluded (chart). December's record mild weather helped, and temperatures in the first half of January may spark a similar boost, especially as a record volume of gift-card redemptions hits the sales numbers.

CONSUMERS SHOWED MOMENTUM AT YEAREND



But the strength is more fundamental than that. Outside weak spots in housing and manufacturing, payrolls in the other 80% of the private sector grew faster in the second half of 2006 than in the first half, and overall incomes grew strongly.

Buying power also got a big boost in the fourth quarter as the price of

crude oil fell from the summer's \$70-per-barrel range to around \$60 per barrel in the fall. Now, a further decline to just above \$50 is unfolding, which will add more oomph to first-quarter spending.

THE GDP REPORT WILL SHOW that considerably slower growth in business inventories was the other major depressant on fourth-quarter economic growth, but the drag will not extend into the first quarter. Stockpiles of goods had grown by \$53.7 billion and \$55.4 billion in the second and third quarters, respectively, even as demand was slowing. The two-quarter jump was

the largest in two years. The unwanted buildup, which was concentrated in motor vehicles and housing-related materials, added to fears that a long period of production cutbacks and layoffs would be needed before businesses could pare inventories back down to size.

Those fears are proving to be unwarranted. The problem was not that big to begin with, based on the inflation-adjusted ratio of business inventories to sales, which measures the adequacy of inventory levels. Through October, the ratio had risen only slightly above its trend since 2000 (chart). This trend has been declining, as new techniques reduce the amount of inventories businesses need to hold. Still, the above-trend increases in 2001 and 2003—which resulted in sharp output cuts—were much greater than the recent rise.

The inventory pullback appears to have subtracted up to a full percentage point from fourth-quarter GDP growth. The slowdown suggests aggressive cutbacks in production and imports through November, along with steady strength in overall demand, have largely eliminated the overhang. So to the extent this stock-level adjustment has already run its course, the stage is set for a rebound in production in the first half of 2007. Indeed, December factory output posted a big 0.7% advance from November, the first monthly gain since August.

IT SEEMS THAT FOR EVERY BIG MINUS in the GDP components last quarter, including inventories and housing, there were counterbalancing pluses to spare. In addition to the big lift from consumer spending, real GDP growth received a sizable boost from foreign trade. That

trend might well continue in 2007, though maybe not positively as in the fourth quarter of 2006.

Thanks to a surprise narrowing in the trade deficit both October and November, the shrinkage appears have added about a percentage point to fourth-quarter growth. The monthly gap narrowed to \$58.2 billion

November, the smallest since July, 2005, as exports jumped and imports slowed.

The slowdown in imports reflected a temporary lull in demand for petroleum products and for materials related to the softness in housing and autos. Still, the deficit should be less of a drag on growth this year because of booming

NOT MUCH OF AN INVENTORY PROBLEM



exports. Overseas demand is strong, especially for consumer goods, and the lower dollar is more competitive.

Add in a solid gain from business investment in equipment and construction, along with another increase in government outlays, and it's easy to see why economists are lifting their expectations for last quarter's growth into the 3% range. More important, the upswing appears to have legs. As the drag from housing and inventories sectors begins to lift in the first half of 2007, the economy seems more likely to speed up than slow down. ■

GLOBAL BUSINESS

A Cash-Grab U.S. Exporters May Regret

AMERICAN EXPORTERS are beginning to raise prices for their goods. A weaker dollar and strong global growth are allowing them to exert a little more pricing power and to juice up their foreign earnings. However, the strategy could be shortsighted.

In the fourth quarter, export prices of capital goods, durable consumer goods, and light vehicles grew at the fastest yearly pace in more than a decade. This acceleration is being facilitated by a renewed easing of the dollar, which makes U.S. exports cheaper in terms of foreign currencies. In 2006, the greenback fell a little over 4% against a basket of 26 other

currencies, bringing the total decline to about 17% since the early 2002 peak. What's more, export demand is strong, with global growth expected to top 4% this year.

Meanwhile, even though a lower dollar makes U.S. imports more expensive, import prices are rising more slowly than those for exports. Prices of foreign-made consumer

goods last quarter were up 1.1% from the year earlier, vs. 1.9% for U.S. exports of consumer goods.

The trends imply a difference in strategy. Many U.S. exporters are taking advantage of current conditions to boost earnings, while foreign companies are holding the line

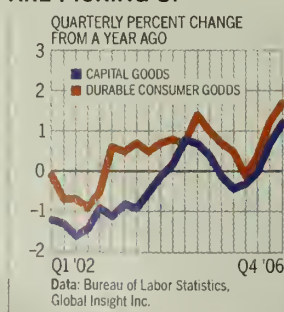
on prices and sacrificing their profits in order to maintain market share.

Such a strategy for U.S. companies could be a loser in the long run. "If we are raising our prices rapidly, we are limiting the opportunities to build markets," says Joel Naroff, economist at Commerce Bancorp. That's a mistake in a global economy. "The dollar won't go down forever and you need to grow market share in other countries in order to survive during the tough times," Naroff says.

U.S. businesses may get another chance to capture market share, both abroad and at home if the dollar weakens further this year, many economists expect. Further declines could finally force imports to ratchet up price increases in the U.S., says Naroff. And that could be a golden opportunity for Corporate America. ■

—By James Mehring in New

WHERE EXPORT PRICES ARE PICKING UP



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The Business Week

News you need to know

EDITED BY HARRY MAURER



Browne Steps Down He's an oil-patch legend who built BP from a weak sister into a supermajor—but that was back in the '90s. On Jan. 12, after a true *annus horribilis*, **CEO John Browne** (photo) said he'll leave the company early, at the end of July. A source says Browne, 58, was tired of being on the firing line following a lethal refinery explosion in Texas in 2005, oil spills and production slowdowns in Alaska, investigations into trading practices, and other woes.

Browne's successor, production boss **Tony Hayward**, seems the obvious choice. His chief rival, **Robert Dudley**, head of BP's key **TNK-BP** unit in Russia, may have been left in place to deal with Kremlin attempts to seize more control of oil ventures with foreign owners. Among Hayward's first tasks: making good on BP's pledge to boost safety measures at its U.S. refineries in the wake of a critical report released on Jan. 16.

ONLINE See "BP's Browne sets earlier retirement," www.businessweek.com/go/tbw

GE Goes Shopping Jeffrey Immelt must have quite a hole in his pocket. Within three days, the **General Electric** chairman and CEO dropped \$12.9 billion in cash. Expanding GE's health-care domain, Immelt was set to announce on Jan. 18 that GE would take two-thirds of **Abbott Laboratories'** diagnostics operations for \$8.1 billion. That deal, which came only two weeks after rival **Siemens** closed on its \$5.3 billion takeover of **Bayer's** diagnostics unit, followed GE's agreement on Jan. 15 to spend \$4.8 billion for British aviation-parts maker **Smiths Aerospace**.

See "Diagnosis: Shrewd moves," page 76

The Energizer Bull Partly in celebration of swifter crude prices, which closed near \$51 on Jan. 16, the DOW index hit a record of 12,582. Cheaper oil, of course, juices the economy—though it makes a rate cut less likely.

See "Barrels of confusion," page 76
ONLINE and "How speculators increase oil volatility," www.businessweek.com/go/tbw

Boring into Apple? Soon after Apple's Dec. 29 closure of repeated options backdating between 1999 and 2003, press accounts reported that the **Justice Dept.** and the **SEC** were investigating. But insiders say the new information was not new to the feds, who had gotten bivouac status reports over the past five months. Insiders say that **CEO Steve Jobs** is not a target, although he played a role and received some of the backdated grants. Moreover, **U.S. Attorney Kevin Ryan**, whose office is handling the probe of Apple, quit on Jan. 17. Whether his replacement wants to tangle with Jobs remains to be seen. Meanwhile, Apple on Jan. 17 reported record profits and revenue.

The Cablevision Chase At first they didn't succeed. Then they sweetened their offer. Finally, on Jan. 16, New York's **Dolan** family still got rebuffed by a special committee of Cablevision's board in their latest effort to take the cable company private. The committee said the offer "does not represent fair value." Now, could **Time Warner** step in as a bidder? After nearly a decade of speculation that the media giant would gobble up Cablevision, whose systems are contiguous with Time Warner's in New York City, this could be the year the Dolans hear an offer they can't refuse.

ONLINE See "Will Time Warner go after Cablevision?" www.businessweek.com/go/tbw

Strange Health-Care Bedfellows How worried are U.S. companies about soaring health costs? Very. Top business groups are so alarmed that they have joined forces with frequent antagonists to create two coalitions committed to spurring reform. On Jan. 16 the **Business Roundtable** teamed up with the **AARP** and the **Service Employees International Union** to launch a campaign pressuring Congress to find bipartisan solutions to health-care and retirement security issues. The second coalition, set to be unveiled on Jan. 18, includes insurance companies, doctors' groups, the **U.S. Chamber of Commerce**, and liberal advocacy groups including **Families USA**.

Bruised Chipmakers The world's biggest semiconductor companies aren't in the chips. The 800-pound giant **Intel**, on Jan. 16 reported sharply lower fourth-quarter earnings and warned that this year's profits won't be as strong as either. One reason: a price war with rival **Advanced Micro Devices**. AMD also is expected to report weak earnings. The two take off the gloves to win share in everything from business servers to consumer notebook PCs.

ONLINE See "Intel fights back as chips are dueling," www.businessweek.com/go/tbw

noil at EMI By failing to merge with **Warner Music** last summer or sell itself to a private equity group, and most recently by firing two top executives, EMI became takeover bait. **Alain Levy**, the CEO for recorded music, and his No. 2, **David Munns**, were ousted on Jan. 11. The world's third-largest music company warned that shares would fall 6% to 10% in the fiscal year ending Mar. But by putting himself in charge of music for now, EMI **man Eric Nicoli**, a former chief at **United Biscuits**, hasn't shed much confidence. Shares sank about 8% following the takeover. Will Warner Music perform an encore to its takeover try?

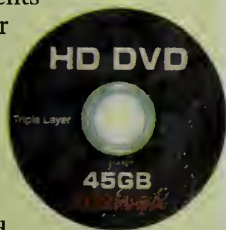
Bye, Bernhard Turnaround ace **Wolfgang Bernhard** Jan. 11 said he'd resign as **Volkswagen** brand chief in the management switch at Europe's largest automaker. Investors are now gripping their seats hoping his two-year restructuring drive doesn't careen off track. But those hopes may be overblown. The new triumvirate running VW—CEO **Martin Winterkorn**, wily **Chairman Ferdinand Piëch**, and **Porsche Chief Executive Wendelin Wiedeking**—is likely to find it just as hard to retool and is working to eliminate state subsidies.

LINE See "What Bernhard's departure means for VW," www.businessweek.com/go/tbw

Bank Under Scrutiny Has iffy commerce gotten **Commerce Bancorp** in trouble? Its shares sank 8.3% on Jan. 11. The Cherry Hill (N.J.) bank revealed that federal regulators had begun an inquiry into real estate deals involving officers, directors, and other employees. Some of the deals apparently involved bank facilities, but neither the bank nor regulators would elaborate further, creating confusion in the market over how severe the consequences of the inquiry could become.

Pirates of the Week

High-definition DVD makers didn't have enough problems with competing formats, here come the hackers. Several weeks after an HD DVD movie watcher announced he had cracked a supposedly foolproof content-protection scheme that prevents unauthorized copying, a much larger group began distributing online a cracked copy of the HD DVD movie *Matrix*. The other format, **Blu-ray**, uses the same anticopying software but adds another layer of protection. Still, it may only be a matter of time before that, too, is cracked. Movie studios can retaliate by trying to sue suspect computers and programs remotely, but that could unleash a public-relations catastrophe and cause a slump in already tepid sales of the rival formats. Innocent people got zapped. The good news for both sides is that there's no universal key allowing widespread illegal copying—yet.



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OIL

BARRELS OF CONFUSION

Where crude prices go next is anybody's guess, so companies are learning to live with volatility—and Wall Street is cleaning up

BY PETER COY

EVEN BY THE STANDARDS of a wild and woolly industry, the oil market has been amazingly chaotic. After hitting an all-time high of \$77 last summer, the price of crude has plunged to near \$52 a barrel.

In the new landscape of volatility, the advantage goes to the companies that can best deal with risk—and that means Wall Street. Investment banks like Goldman, Sachs & Co. are doing land-office business selling customized hedges to oil consumers that need protection from the ups and downs of the oil market. And with 530 energy hedge funds today, up from just 180 in October, 2004, the financial sector's involvement in oil trading—and its ability to profit from movements in either direction—has never been greater.

But is Wall Street responsible for causing the volatility that it so enjoys? Some say yes. Peter C. Fusaro, co-founder of the Energy Hedge Fund Center, which tracks hedge fund involvement in the energy sector, argues:

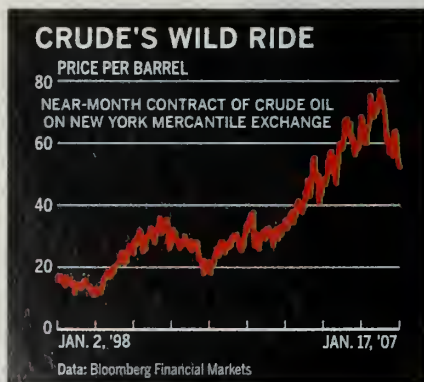
“Now we're seeing bigger price moves, \$2 a day. We never saw that before.”

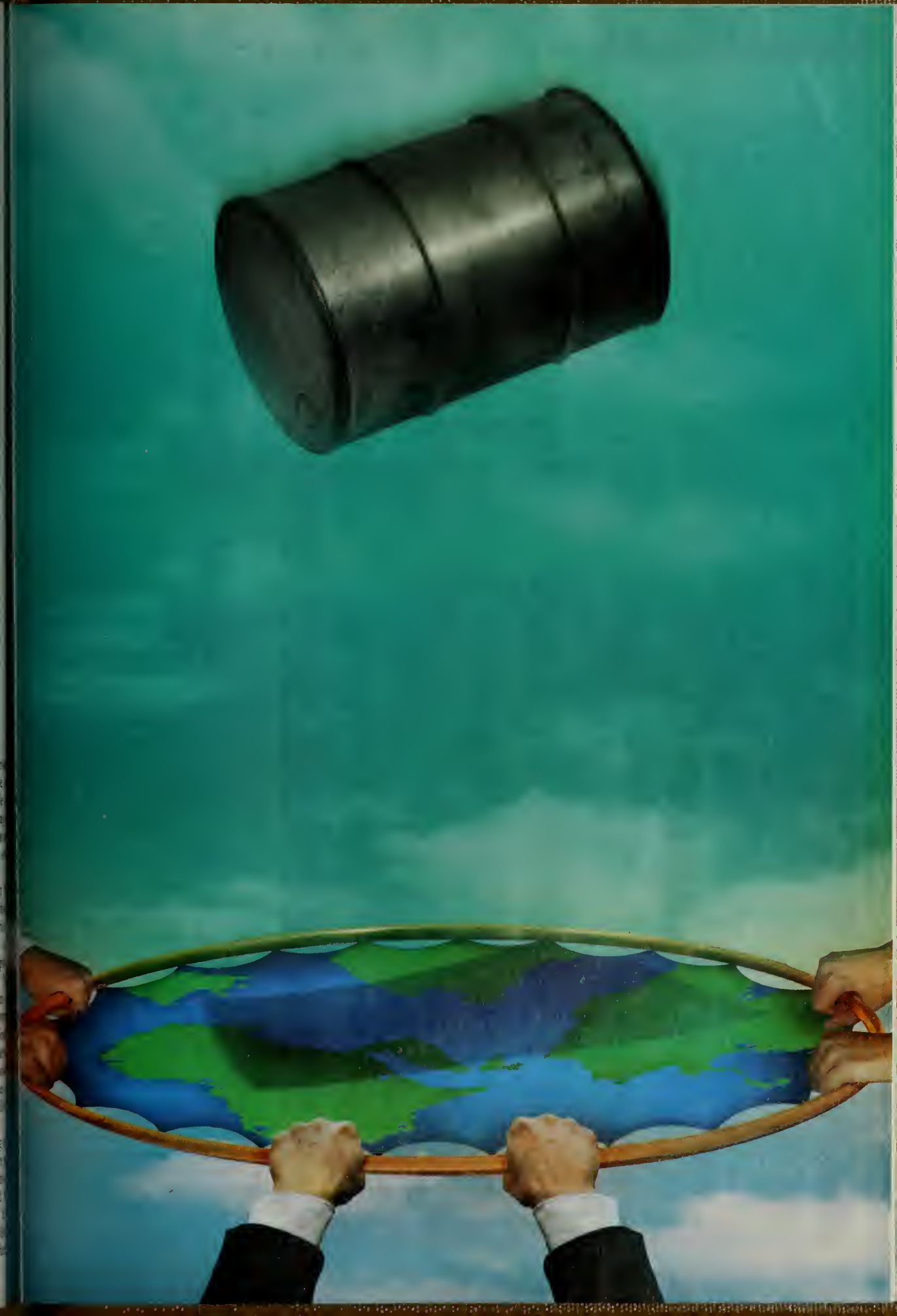
For the most part, though, financial investors aren't causing long-term price gyrations; they're simply exposing the volatility that exists in the real world. With their rapid-fire buying and selling, the new breed of oil-market investors is causing prices to respond more quickly to actual developments. That's a good thing, since producers and consumers of oil have timelier information for making decisions about, say, drilling a

new well. “The financial market really the messengers. They've created more transparency around the volatility that was always there,” says Hancock, co-founder of Integrate Finance Ltd., a New York-based strategy advisory firm.

The inescapable fact is that the little excess oil so any perturbation in supply or demand can send prices surging or plunging. And there are perturbations aplenty. Driving prices are political instability in the Middle East, strongly rising demand from China, stormier weather from global warming, and a lurking fear that oil production may have peaked. Driving them are new fields brought into production to take advantage of high prices, as a warmer winter and the possibility of a price war inside OPEC.

The futures market is betting on prices to rise about \$7 a barrel over the next few years, to \$59. But no one has much confidence in this forecast. David A. Yergin, chief economist of Standard & Poor's, sees oil averaging in the low-\$60s over the long term, but he likes to give his price pr





tion with a self-deprecating disclaimer: "plus or minus \$30."

For the time being, cheaper oil is unquestionably a welcome development for the world economy. Merrill Lynch & Co.'s North American economist, David A. Rosenberg, estimated in a research note on Jan. 16 that the oil price decline would add 0.75 percentage points to U.S. economic growth in the first quarter. He said cheaper oil was as good as three interest rate cuts by the Federal Reserve. But in a larger sense, the volatility of energy prices imposes a real cost by disrupting decision-making. Oil companies, automakers, airlines, and manufacturers all need to have some idea about the future price of crude to run their businesses efficiently. And investment in the alterna-

tive-energy sector is exquisitely sensitive to long-term forecasts of oil prices.

On the bright side, there are ways to live with volatility. The vastly increased volume of speculative trading in oil futures has increased market liquidity. The amount of unsettled oil contracts or "open interest" on the New York Mercantile Exchange—a measure of the volume of trading—hit a record 1.28 million barrels in early January, according to the Commodity Futures Trading Commission. In the past, "only those who could physically store large quantities of oil had the abil-

Northwest's bet on higher fuel prices is costing the airline plenty now

ity to trade," former Chairman Alan Greer said in congressional testimony last year. But he said, "the new pants, investors and speculators," were "hastening the market's adjustment to tighter supplies."

Firms like Goldman Sachs are expert at taking on risk from those who wish to shed it, carving

up, and selling the pieces. In the 1990s, Wall Street was encouraging energy companies like Enron, Mirant, and others to develop in-house trading expertise. But after Enron blew up in 2001, the investment banks "did a 180" on the industry and said, "Why are you taking these untoward risks?" Stephen Schork, editor of *The Street*, an energy newsletter, says Enron trading rapidly moved from Houston to the financial centers of Manhattan and Greenwich, Conn.

For nonfinancial firms, meanwhile, dealing with oil price volatility means buying the protections that the financial sector is selling or finding their own ways to defray risks. General Motors Corp., for example, is hedging its bets without the help of Wall Street's help by playing both sides of the street. It's churning out gas-guzzling sport-utility vehicles (in hopes of selling more oil) while simultaneously developing fuel-sipping Chevrolet Volt, a hybrid that you plug into the wall at night. GM chief market strategist Paul Baer says, "We have to be ready if it's selling for a barrel or if it's \$60 a barrel."

HEADACHE

EASY TO SAY; tough to do. Repetitive gyrations keep blindsiding oil producers and consumers. Pity, for example, poor finance folks at Northwest Airlines, who thought it would be prudent to lock in the cost of jet fuel in 2006 when prices went even higher. Northwest, which is under Chapter 11 protection from creditors, hedged fully half of its fourth-quarter fuel needs at \$65 a barrel of crude oil. That was above what it would have paid if it had bought all its jet fuel on the spot market. UAL, AMR, and Delta also put on hedges that ended up costing them millions. AMR CFO Thomas W. Horton says hedging was about break even for the company, producing gains in the first half and losses in the second half. "Hedging is one of those things you have to be comfortable with," Horton says.

What's Really Going On With Oil Prices?

Price volatility makes it extremely difficult for both producers and consumers of oil to plan ahead. Here are some benchmarks they're using:

\$5

The cost of producing oil from the best Mideast fields. Prices could fall to this level before Saudi Arabia would start losing money on each barrel.

\$25-\$30

The price at which oil companies test projects for profitability before committing to them.

\$52

Price of oil for delivery in February, 2007, on the New York Mercantile Exchange as of Jan. 17.

\$61

Price of oil for delivery in December, 2012, on the New York Mercantile Exchange as of Jan. 17.

\$62

Standard & Poor's forecast of average oil price in 2007.

\$77

Price reached in August, 2006.

\$105

Price of oil in a "super-spike" scenario laid out in 2005 by Goldman Sachs.

\$200*

Minimum oil price in 2010, in a bet by investment banker Matthew Simmons.

(TOP TO BOTTOM) STEVE LABADESSA; STEPHEN HILGER/BLOOMBERG NEWS

*In 2005 dollars

A Fast New Financial Game Called Energy



ENERGY CONSULTANT PETER C. FUSARO, chairman of New York-based Global Change Associates Inc. and co-founder of the Energy Hedge Fund Center, was among the first to notice the growing role of hedge funds and other financial players in the energy sector two years ago. He talked to Washington correspondent Lorraine Woellert about how the trend is contributing to price fluctuations and where it's going next.

the surge in oil futures trading acerbating the market's ups and downs?

The Commodity Futures Trading Commission of New York Mercantile Exchange put out a study saying hedge funds weren't using more volatility. That's nonsense. Traders are attracted by volatility. In the '90s we had pretty flat markets. We didn't have a lot of trading volume. Now we're seeing bigger price moves, \$2 a day. We never saw that before.

What kicked off this trend?

The trigger was availability of talent. Enron went down in 2001. Utilities started exiting energy trading. You had this meltdown of natural gas and power trading. Some of these folks started their own hedge funds, and some were hired by hedge funds. You had this pool of talent.

Where did price increases come in?

We had higher energy prices beginning in 2004. People wanted to come into energy because it was headline news.

Volatility is a huge headache for oil companies as well. John Felmy, chief economist of the American Petroleum Institute, says: "It really gives one the chills. You're making bets on investments that are going to run 30 or 40 percent." Stefano Cao, general manager of exploration and production at the oil giant ENI, laughs that the company doesn't have an oil-forecast. "He would be fired every month. The rule of the game in our industry is never tries to gauge and decide on points based on a specific oil price is to be wrong by definition."

Banks and insurers also are in the game.

Banks are really the biggest player in this market. They have the capital base, the global positioning, the traders. They have the relationships, they're in project financing.

So interest in the energy sector is moving away from owners and consumers?

This is a financialization of the energy markets, and it's immature. We size it at \$3 trillion, compared to, say, \$26 trillion in interest rate swaps. Energy is the world's largest business, at \$4 trillion. It should trade at 6 to 20 times the physical market. The growth potential is enormous.

What's the downside?

Risk, risk, risk. Energy is a risky business. You've got headline risk, weather risk, geopolitical risk—it just goes on.

What about volatility?

We saw a big hedge fund go down—Amaranth Advisors. But that's only 1% of the market.

Fear of being caught by a sudden price drop makes oil producers highly risk-averse. In bidding for oil leases or buying smaller companies, most of the majors set a "hurdle rate" of \$25 or \$30 a barrel, meaning their investment has to pencil out as profitable even if oil prices get that low, says Nariman Behravesh, chief economist of Global Insight Inc. Companies like Exxon Mobil Corp. may not even entertain an acquisition when oil prices are above \$40 because potential targets would be emboldened to ask too much.

But even for conservative oil giants, the existence of a deep, active financial

market...but [hedge fund investing] is too risky for small investors. This is big money that should know the risks and afford to lose it. Energy trading is a zero-sum game. When Amaranth lost \$6 billion, somebody made \$6 billion on the other side.

London's Intercontinental Exchange came into this space about a year ago. What has that done?

ICE launched West Texas Intermediate crude futures last February. It was the biggest launch ever in trading contracts, [and] a lot of it was hedge-fund-driven.

Why so big?

They're totally anonymous. That's an attraction for traders. If you're trading on the commodities floor, people know your positions. You know the size, the direction, the scale, the length of the trade. You don't know any of that in cyberspace.

You predict that green trading is the next big thing.

The global carbon emissions market was about \$25 billion for 2006, and it's doubling every year. Once the U.S. enters a carbon-trading regime, the uplift will be incredible.

Where is the money coming from?

It's coming from high-net-worth [individuals] and private equity. There's unprecedented interest in clean energy. ...When you put that together with the world's largest business—energy—it's going to be huge. It's absolutely a new asset class.

market is a plus. The collective wisdom of the world market produces a view of the future that their own internal planning staffs can't match.

It's not just PhD quants or highly paid traders who are affecting world oil markets. It's the little guys who have started to put, say, 5% of their retirement money in a commodity fund. More than \$100 billion is now invested in commodity funds that track the Goldman Sachs Commodity Index or the Dow Jones-AIG Commodity Index.

Not satisfied with simply trading in the futures market, some financial firms

are getting their hands dirty by buying physical assets such as pipelines and terminals, as Enron once did. This gives them a perfectly legal inside look at the workings of the energy market. The Fed fueled the trend in 2003 by allowing commercial banks to take possession of physical assets. Goldman Sachs has a stake in a Kansas oil refinery and a natural gas pipeline running through New York and Connecticut, among other holdings. In August, Kinder Morgan Inc., a Houston-based energy transportation and distribution company, said it was being acquired by a consortium led by Goldman Sachs, AIG, the Carlyle Group, and Riverstone Holdings in a deal valued at \$22 billion. "Having a direct and intimate involvement in the asset enhances our access to information" such as where

Now the finance guys are buying assets like pipelines

the bottlenecks are, says Paul Addis, co-CEO of a new venture between Highbridge Capital Management, a New York-based hedge fund, and commodities house Louis Dreyfus Group.

But this kind of special access is coming in for criticism. In a June, 2006, report, the Senate permanent

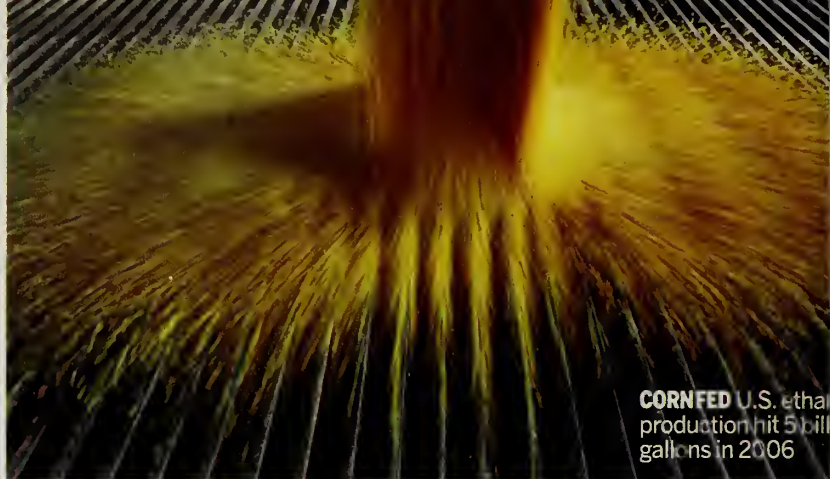
subcommittee on investigations concluded that such "excessive speculation" in oil by hedge funds and private equity groups has distorted market signals. "How much of the volatility is because of supply and demand, and how much from uncompetitive trading practices?" asks Tyson Slocum, director of the energy program at Public Citizen, a Washington-based consumer rights group. "We're glad to see prices go down. The problem is that the volatility isn't good for anyone."

Actually, it is good for traders. But don't blame the Street. The gyrations are real, and they're here to stay. ■

—With Lorraine Woellert in Washington, David Welch in Detroit, Moira Herbst in New York, Michael Arndt in Chicago, and Gail Edmondson in Paris

BusinessWeek weekend

TELEVISION: For more on volatility in oil prices and what it means for companies and consumers, watch our weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com to see video clips or type in your Zip Code to find when and where it airs in your area.



CORNFEED U.S. ethanol production hit 5 billion gallons in 2006

ENERGY

MEMO TO CONGRESS: FIRST, DO NO HARM

Capitol Hill's rush to promote alternative fuel could yield some damaging legislation

BY JOHN CAREY AND EAMON JAVERS

OIL PRICES MAY HAVE dipped, but Washington's enthusiasm for curbing America's oil addiction hasn't wavered.

Senate Agriculture Committee Chairman Tom Harkin (Iowa) is pushing a bill that requires ethanol and biodiesel production to jump tenfold by 2030, one of scores of similar measures. President George W. Bush is expected to announce new incentives for ethanol in his State of the Union speech. Add in a flood of bills mandating limits on carbon dioxide emissions, which would also boost fuel alternatives, and "this is the first time in 30 years of working on energy legislation that I've seen a consensus that major changes are essential," says Philip E. Clapp, president of the National Environmental Trust.

Yet even as ethanol supporters bask in the bipartisan attention, they fret that good intentions could go awry. "This is a very dangerous situation. There are all these people who just discovered ethanol, and they're introducing all these bills," warns House Agriculture Committee Chairman Colin Peterson (D-Minn.). "Fifty percent of them will do more harm than good."

Take the idea of mandating a big increase in renewable fuel for cars. The 2005 Energy Bill requires refiners to use

7.5 billion gallons of ethanol per year by 2012. Combined with the existing 51¢-per-gallon tax credit and soaring prices, that provision has triggered an ethanol investment boom. Production leapt to 5 billion gallons in 2006, and the industry will have the capacity to produce more than 11 billion gallons by 2009.

The problem: That capacity built up against the so-called blend wall. Auto fuel that contains more than 15% ethanol is too corrosive to use in existing gas station pumps. Without new pumps and cars capable of running on 15% ethanol fuel, the U.S. can't use more than 8 billion to 10 billion gallons of ethanol a year. "We've done a better job focusing on production than we have on distribution," concedes booster Sen. Barack Obama, a probable Democratic Presidential candidate who hails from corn-producing Illinois.

What some experts see as the best policy may be the least likely to pass: on oil that kicks in only if the price falls below, say, \$40 per barrel. "That will keep OPEC from dropping the price to drive out ethanol," explains veteran capitalist and ethanol investor V. Khosla. Democrats, however, fear they can't get the new taxes by Republican.

At this point, ethanol backers are hoping that Congress doesn't do things worse. Says Peterson: "Just screw us up." ■

REGULATION

NOT EVERYONE HATES SARBOX

The much maligned new rules are a big hit with investors

DAVID HENRY

THERE HAS BEEN no shortage of public outcry over Sarbanes-Oxley, the controversial 2002 accounting re-legislation that requires corporate executives to fill out a host of new forms and annually certify their financial reports. SarbOx, say its critics, has cost millions in compliance and makes life miserable for corporate directors, and encourages companies to bolt to foreign stock exchanges. The complaints have been so passionate that regulators are now planning to loosen the rules, only before the year is out. So fast, says a growing chorus of investors. Lost amid all the boos over SarbOx, they say, are some major benefits: SarbOx and related reforms have produced much more reliable corporate financial statements, which investors rely on when deciding whether to buy or sell shares. For them, SarbOx has been a godsend. What's more, says Duncan W. Richardson, chief equity investment officer at Eaton Vance Management and overseer of \$10 billion in stockholdings, even the most disparaged requirements for internal financial controls could be gains in corporate productivity and profitability. Says Donald J. Peters, a portfolio manager at T. Rowe Price Group: "The SarbOx reforms have been a win." Earnings will be on investors' minds for the next several weeks as most companies announce yearend results. Numbers will include results tallied under generally accepted accounting principles and, thanks to a Securities &



Exchange Commission regulation adopted during the reform years, they'll also come with reconciliations to any nonstandard or "pro forma" numbers that companies use to try to spin their results. The reconciliations, says Peters, are "extraordinarily" helpful. "It is [now] much easier for me to have a view of the true economics" of a company, he says. Beefed-up disclosure requirements have also meant that companies now deliver numbers with fewer adjustments for unusual charges and write-offs, which in the past have been used to make earnings look better. Thomson Financial's Earnings Purity Index, which tracks earnings adjusted for such write-offs, shows improvements in each of the past four years. And now earnings reports reflect expenses for incentive stock options, information investors like that wasn't available before the big accounting scandals.

Just as important, executives appear to have a firmer grasp of costs when they talk about operating margins, according to Richardson of Eaton Vance. He credits the improvement to the infamous Section 404 of SarbOx, which requires documented testing of internal controls. "Even not-so-good management teams have good controls now, and that leads to an ability to cut costs," he says.

This isn't to say SarbOx is flawless. Section 404 is often applied unreasonably, causing costly checks of minor book entries. It's bad, too, that small-scale businesses find fewer benefits relative to the costs.

TRUE TEST

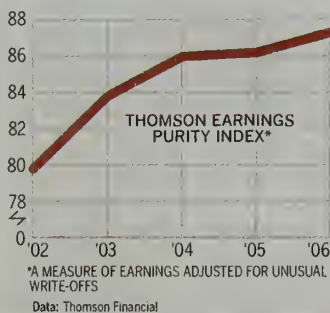
NOR DO THE reforms mean that investors can trust the numbers implicitly. These days, financial reports increasingly include ad hoc performance measures other than closely regulated earnings, says Marc Siegel, research director at the Center for Financial Research & Analysis. "Companies are going to greater extents to hide" the true stories of their cash flows, order backlogs, bookings, and same-store sales, he says. Siegel notes that Duke University scholars found executives will go far to spin their numbers: Some three-fourths said that to meet earnings estimates, they will sacrifice corporate value, even if it means postponing profitable investments, deferring maintenance, or giving incentives to customers to buy before the end of a quarter.

Of course, the real test for how much earnings reporting has improved won't come until the next economic downturn, says UBS stock strategist David Bianco. In downturns, the lack of growth often exposes aggressive accounting estimates used to manipulate earnings. And that's when some capital investments are revealed to

have been hiding operating costs.

Still, the next round of abuses to surface will probably not be as bad as it would have been without the reforms. Says Eaton Vance's Richardson: "You're always better going into any downturn with tighter rules." For regulators eager to start tinkering, that's food for thought. ■

CLEANER RESULTS



PRIVATE PLANES

ONE JET, 16 OWNERS, BIG PROBLEMS

NetJets, Flexjet, and other fractional operators have severe growing pains

BY DEAN FOUST

WHEN FRACTION-Air Inc. opened for business in 2002, its possibilities seemed endless. The Nashville company, which sold fractional interests in private jets, was backed by a who's who of Tennessee business and politics, including former Democratic U.S. Representative Bob Clement. Over time the venture's impressive customer list boasted former Vice-President Al Gore, ex-Dallas Cowboys star Troy Aikman, and Tennessee Titans coach Jeff Fisher. But by last fall, FractionAir was grounded, with its creditors and jet owners busy filing lawsuits to recoup whatever they could of their investments after the business proved more difficult than anticipated.

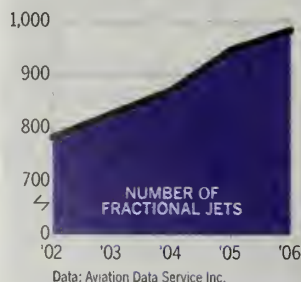
FractionAir's experience illustrates the growing pains facing the \$6 billion industry. Despite brisk demand—more than 5,000 individuals and businesses now own fractional interests in private jets, up from 730 in 1997—the companies operating these services, including NetJets, Bombardier Flexjet, and Flight Options, have collectively lost hundreds of millions of dollars in recent years. “Given the demand, it makes no sense that the operators are losing money,” laments Steven F. O'Neill, CEO of Greenwich (Conn.)-based Citation-Shares, which operates a fleet of 81 Cessna jets.

Why the losses? Industry experts say the business model has vexing problems. For one thing, providing a ready, waiting jet for a multitude of customers—many



IN FLORIDA Flight Options planes

CROWDED SKIES



jets are now sold in increments as small as 1/16th—is more complicated than it may appear. Experts estimate that more than 25% of an average plane's air time is spent flying empty to pick up the customer. And because many people travel at the same peak times—the day before major holidays,

or Monday mornings—operators have too often been forced to turn to the costly charter market just to meet their contractual demands. NetJets Inc., for instance, estimates it spent \$200 million

chartering extra jets in 2005, the says it cut its charter outlays to less than \$100 million last year.

Analysts add that a good portion of the existing stock of business jets, such as Hawker 1000 and Cessna Citation, were built for corporate users who fly them less than 300 hours a year, far from the roughly 1,100 hours that most fractional operators wring out of an airplane. The unfortunate result: costly maintenance and excessive downtime. “A lot of these light business jets were not designed to be flown like a commercial airplane,” says Mike Riegel, a Flexjet executive who now advises

fractional operators. And experts say that jet operators, in their rush to gain market share, have been way too aggressive in selling their own jet acquisitions, which in turn forced them to discount their rates to attract customers. “The fractional players have been just like the commercial airlines—they’ve been pricing jets to fill seats,” says Richard Aboulafia, vice-president of Teal Group Corp., an aerospace consulting firm in Fairfax, Va.

OFF-PEAK REWARDS

EXECUTIVES AT the fractional operators say they are optimistic. Many say they’ve begun phasing out older gas-guzzling jets in favor of newer, more efficient jets like the Bombardier CRJ-900 and the Cessna 441. And a number of companies have started to reward plane owners for flying off peak, which has reduced reliance on costly charters to meet demand. NetJets CEO Richard T. Santulli says his company cut its use of charters from 8% in 2004 to just 1.75% last year, a move that analysts believe enabled the Berkshire Hathaway Inc. subsidiary to turn a profit in 2005 after losses in three of the four previous years. “Contrary to what everyone says, the model works,” says Santulli. “We continue to be profitable.”

Longer-term, many analysts still believe a shakeout is possible. Says aerospace analyst David Strauss: “The best thing that could happen to this industry is consolidation—taking out a couple of the lesser players who just keep down prices.” ■

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COMMENTARY

BY DAVID WELCH

Sacrificing Size for Success at GM

Why it should step back and let Toyota be the No. 1 carmaker

A NOTE TO THE EXECUTIVE suite at General Motors Corp.: Maintaining the crown as the world's largest automaker doesn't matter. If you can't keep it while boosting profits, let Toyota have it. Let Toyota face the scrutiny of being No. 1. Then you can focus on increasing profits. Given the hypercompetition in the global auto market and

the rate at which technology is changing, GM will need many billions in cash to stay in the game.

GM Chairman and CEO G. Richard Wagoner Jr. says his focus is profitability. But if he is seriously looking at buying troubled Malaysian carmaker Proton Holdings—which GM acknowledged on Jan. 16—he may be falling back into GM's long-held obsession with size and market share. Remember, this is the company that, after five years of sacrificing profits for market share, spent the past year trying to wean its dealers and buyers from a discounting strategy. GM also forged alliances with smaller carmakers as a way to boost output. But GM sold those stakes over the past two years both to raise cash and to extricate itself from an alliance strategy that generated more trouble than value.

'IT'S GOING TO BE A DOGFIGHT'

IN OTHER WORDS, buying Proton for anything above a fire-sale price would be a sign that Wagoner feels the temptation to safeguard GM's crown. While GM insiders swear their interest in Proton isn't just a defensive maneuver—it would give them small cars and a presence in emerging markets—there is plenty of evidence saying otherwise. In the global sales race, Toyota trails GM's 2006 sales of 9.1 million by about 250,000 vehicles. Considering Toyota's growth and the fact that it is adding 320,000 vehicles worth of production this year in North America, the two companies will be in a tug of war for the sales crown. Wagoner said at the Detroit auto show on Jan. 9 that he isn't ready to concede the top spot to Toyota. "It's going to be a dogfight," he said.

If GM grabs a big enough stake in Proton, Wagoner add 180,000 vehicles to its annual tally. A lesser stake would still enable GM to build more cars in Proton's underplants. Considering that GM sold 5 million vehicles outside the U.S. last year, up 7% from 2005, even small partnerships could keep GM ahead. Plus, Proton's chief competitor is allied with Toyota-controlled carmaker Daihatsu. GM might be worried that Toyota will use that connection to dominate the Malaysian market and others in the region.

GM says Proton talks are at an early stage. As they progress, Wagoner may realize GM doesn't need Proton or its head, Tan Sri Dr. Tony Fernandes. Proton, after all, is losing money. It's valued at \$1 billion despite a forecasted 2006 loss of \$127 million on sales of \$1.9 billion. GM already has its GM-Daewoo operations in Korea to make

compact cars for emerging markets.

Suppose GM passes on Proton and a few other sales-boosting initiatives that could help it fend off Toyota. There could be some fringe benefits. Toyota's rapid growth has come at a price. Developing so many new models has taxed its engineers, and recalls in the U.S. and elsewhere have more than tripled in the past three years. Toyota has delayed a few models to double-check for glitches, and recalls haven't dented Toyota's teflon image for quality, but if problems persist, they will.

Environmentalists who have loyally buffed Toyota's green image are already criticizing its move into big markets like SUVs and pickup trucks. The Union of Concerned Scientists (UCS) still thinks Toyota has a fine green track record, but says its new pickup is a gas hog, and that's a concern. "It's like they're trying to outpace GM on going backwards on

economy," says David Friedman, a research director at UCS.

That's just the kind of publicity GM would love to share with Toyota. Or, as Vice-Chairman Robert A. "Bob" Lutz puts it, it could be a relief in some ways. Let someone else be the guy who sticks his face in the hole in the rubber sheet. And for GM's sake, let Wagoner be the guy who passes up global bragging rights in exchange for bottom-line results.



A stake in Proton could help GM keep the sales crown, but at what cost?

Sandra Meyer loves Ohio's energy.

Sandra has found Ohioans to be friendly and engaging. She likes being personally involved with the community at events like the annual Duke Energy/CSX Holiday Model Train Display.

SANDRA MEYER'S STORY

"Church, family, friends and community are very important to my husband and me. We both love living and working in Ohio."

Sandra Meyer, President
Duke Energy Ohio and
Duke Energy Kentucky

Everywhere she goes, Sandra Meyer exudes positive energy. Now that she's moved to Ohio to become President of Duke Energy of Ohio and Kentucky, there's no mistaking her enthusiasm for her new home state.

Duke recently merged with Cinergy of Cincinnati to diversify its interests and establish itself in Southwest Ohio's growing economy. Since moving here from Charlotte, Sandra has been impressed by a variety of beneficial business resources in Ohio, including abundant fuel supplies and an outstanding transportation infrastructure of roadways, railways, airlines and the scenic Ohio River. She's also impressed by the growth of future technologies, the welcoming, collaborative attitude of her fellow business leaders, and their commitment to work together for the betterment of the community.

Sandra also enjoys an extremely gratifying personal life in Ohio. She appreciates the way the city has been able to grow while preserving its rich history and beautiful, vibrant downtown. Her office view overlooking the Great American Ball Park is awe-inspiring for an avid sports fan like Sandra, and she and her husband have become regulars at Reds and Bengals games. Other favorite destinations include Cincinnati's many theater and fine arts opportunities and its world-class Zoo.

Sandra's career has called for several moves. She believes the move to Ohio is one of her best. **See why at OhioMeansBusiness.com or call 1-877-466-4551.**

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OCTOBER
Mobile-phone
employees
protest layoffs

Push and Pull

Klaus Kleinfeld has brought American-style management to Siemens, but he often encounters resistance.

ACTION

Dumped money-losing mobile-phone unit on Taiwan's BenQ at a cost of \$1.4 billion.

Put troubled communications-equipment unit into joint venture with Finland's Nokia.

Invited workers to comment on his blog in an effort to get closer to employees.

Boosted proportion of management pay tied to performance, resulting in big raises.

REACTION

Public pressure spurred Siemens to pay \$46 million to retrain workers after BenQ closed the business.

Workers felt betrayed—and now the transaction is on hold because of the bribery scandal.

Dozens of scathing posts accused Kleinfeld of destroying the company's culture.

Critics say the move was little more than a bonanza for executives who cut jobs.

a supermarket and taking on other part-time jobs to help make ends meet. Later, while working full-time at Siemens, he completed his doctoral work on corporate communications strategy, which was published as a book.

Today, Kleinfeld is as comfortable hobnobbing with global leaders as he is chatting with entry-level employees. September found him speaking about climate change at the Clinton Global Initiative in New York, then meeting workers in a nearby suburb.

He also knows how to enjoy himself. In December, Kleinfeld danced the night away at a Christmas party for U.S. employees at New York's B.B. King Blues Club. He even plays a decent blues

harmonica, though never in public.

One of Kleinfeld's problems is that few inside Siemens can match his energy. The Old Guard tend to grumble that Kleinfeld is too impatient and demanding. Soon after taking office in January, 2005, he vowed that Siemens would finally achieve ambitious profit-margin goals established in 2000 for each unit. The targets range from 6% for auto parts to 13% for the top-performing medical-equipment division. Kleinfeld staked his job on the company hitting those numbers by April, 2007—which now looks likely, analysts say. His message: Everyone, including the boss, is accountable. "We commit to something, and we deliver," Kleinfeld says. "That is

too long to alert him to the problem. Kleinfeld transferred the most profitable parts of the division, such as baggage handling systems for airports, to other parts of Siemens. The rest was sold. Within weeks, an entire Siemens division with \$1.9 billion in annual sales was vaporized. Around Siemens, there is a collective gasp.

TOSSING OUT TELECOM

HE HAS BEEN equally tough on other sacred pieces of the Siemens empire. Founder Werner von Siemens gave his name laying intercontinental telegraph lines in the mid-1800s, but didn't stop Kleinfeld from getting out of communications businesses. He

the culture we want to create. Change across such a sprawling enterprise is a massive challenge. The company's 11 business units operate as separate entities, with their own boards and distinct corporate cultures, making it difficult for directives from the top to filter down to the troops. executive says Kleinfeld's biggest impact so far has been increased pressure to speak English throughout the company—hardly an earthshattering reform. And while Siemens excels at technological breakthroughs, such as mobile phones with built-in MP3 players, they have often suffered because of poor marketing and a lack of focus on the customers who use the products. How do you persuade Siemens' vaunted engineers to pay attention to customers? Kleinfeld declared that he would personally visit Siemens' 10 biggest clients in his first 100 days in office. He wound up meeting more than 300 of them.

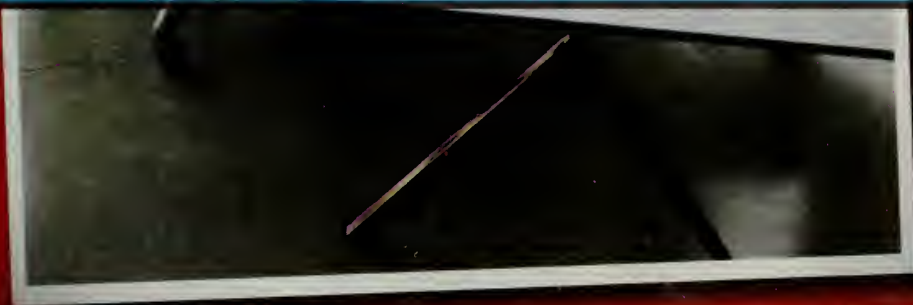
Kleinfeld isn't shy about administering harsh discipline when he feels it's necessary. That's something new for a 159-year-old company. At the end of 2005, it became known that the Logistics & Automation Systems Div., which makes products such as sorting equipment used by the U.S. Postal Service, would deliver a 2% profit margin. Most unbelievable in Kleinfeld's eyes was that the unit's managers

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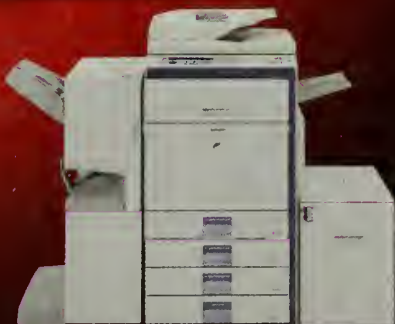


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Taiwan's BenQ Corp. to take the money-losing mobile-phone division off his hands at a total cost to Siemens of \$1.4 billion. And he put most of Siemens' telecommunications-equipment business into a joint venture run by Finland's Nokia Corp. But the Nokia deal has been delayed until questions about the bribery scandal are cleared up. In September, BenQ declared the German handset unit insolvent. Although Kleinfeld insists he thought it had a future under BenQ,

workers have charged that he should have foreseen the disaster. In the face of pressure from labor leaders and German politicians, Siemens ultimately coughed up \$46 million to aid workers who lost their jobs.

Some Siemens watchers say Kleinfeld has become more cautious following the bribery investigation and the uproar over his restructuring moves. Those controversies clearly rob him of political capital, and plenty of people both inside

and outside Siemens would surely to see Kleinfeld fail. Says a consultant who has worked closely with Siemens: "Some people are betting that he doesn't survive and that they can go on in a normal way."

Kleinfeld, though, has no plans to step up, and he is pressing to reshape "normal" ways in which the giant company operates even as the investigation continues. Says Kleinfeld: "We are stronger than ever." ■

INDIA

The Sweet Smell of Demand

For a glimpse of the kind of future Siemens Chief Executive Klaus Kleinfeld envisions for his company, head for the Indian city of Kalwa, outside Mumbai. At Siemens' sprawling complex there, more than a half-dozen factories make a broad range of industrial equipment. The newest is a 130,000-square-foot plant that will produce giant electrical transformers. Although the facility isn't scheduled to reach full capacity for months, India's hunger for electricity is so intense that orders have been rolling in fast—which should help Siemens' sales to India's power industry keep climbing after doubling last year to \$447 million.

Despite the low-tech construction methods—women in saris carry pans of dirt on their heads and men lift steel girders into place with ropes and pulleys—Kalwa is infused with the energy and drive that come with booming growth. Those are exactly the traits Kleinfeld wants to instill in Siemens worldwide. Even as he tussles with German unions and struggles to slash costs at home, Kleinfeld is pushing ahead with big expansions in India, China, Russia, and elsewhere.

In Germany, the debate is about how to manage job cuts. But in much of the rest of the world, Siemens has the opposite problem: It can barely keep pace with its growth. In Asia, Siemens' sales jumped 28% in fiscal 2006, to \$16.7 billion, or 15% of the company's overall revenues. The



KALWA PLANT Fueling sales of power equipment

expansion means a nine-story Bangalore office building—completed in 2005 and intended to provide enough growing room for years—is nearing capacity as the company offers a bonus to employees who get a friend to sign up.

One such worker is Vishnu Swaminathan. The 31-year-old earned his doctorate from Duke University in 2003 and since then has been a researcher for Siemens. Swaminathan found a way to produce a digital video camera for about \$100—or 10% of what outside suppliers were charging. The low-cost

camera will make it possible for Siemens to sell traffic lights that can, for example, switch to green when too many cars build up in a given direction. "It's no longer about cheap labor, but about high value," says Gerd Hoefner, a vice president at Siemens Information Systems Ltd. in Bangalore.

Success in India is also about getting the right products to market quickly. Siemens learned that lesson the hard way when it was slow to introduce low-cost mobile phones in the country, missing out on what proved to be the fastest-growing cellular market in the world. Now, Siemens seems to be getting smarter. The Medical Solutions Div., for instance, sells X-ray scanners in India without some nonessential features, to make them more affordable.

As India gets richer, it is growing in importance for Siemens. Last year the company sold some \$1 billion in goods

there, giving it a comfortable lead over rivals such as General Electric Co. in providing the technology India needs to keep traffic flowing smoothly, produce reliable electricity, and supply drinkable water. GE, with sales in India of \$700 million, is coming on strong, though for now there seems to be plenty of room for both titans. Says Anil Laud, a former IBM executive who oversees Siemens' operations in Bangalore: "One really has to live here to see how it is thriving."

—Jack Ewing in Kalwa, India

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COMPUTERS

A RACER CALLED ACER

Look out, Lenovo. The world's No.4 computer maker is gaining on you

BY BRUCE EINHORN

IT'S A GOOD THING GIANFRANCO Lanci likes coffee. He shuttles between his home in Milan and job in Taiwan as president of computer maker Acer Inc. And despite the 16-hour journey, his schedule makes no allowances for jet lag. After landing in Taipei, Lanci plunges right into a full day of meetings. His secret? It might have something to do with the gleaming Lavazza espresso machine Acer installed to accommodate his six-demitasse-a-day habit. "You cannot waste time, since you spend so much time already on the plane," says Lanci, 52. "The coffee," he adds, "also helps."

Acer seems to be on a caffeine kick of its own. Americans who know the brand likely recall it hit the big time in the '90s, then quickly fell into obscurity. While Acer remains weak in the U.S., globally it's No. 4 in PCs overall, behind Hewlett-Packard, Dell, and Lenovo.

MILAN TO TAIPEI
Under Lanci, Acer became Europe's No.1 laptop seller

Last year, Acer boosted its share by 1.2 percentage points, to 5.9%,

according to preliminary data released by researcher IDC Corp. on Jan. 17. That puts Acer just behind Lenovo, which rose to No.3 when it bought IBM's PC division two years ago. Lenovo is "successful in China, [but] we are growing everywhere," says Acer CEO J.T. Wang.

The battle to overtake Lenovo is about more than just bragging rights. The PC industry has shrunk to a handful of players, and more consolidation is likely. For Acer, getting bigger is "a survival issue," says Kevin Chang, an analyst in Taipei with Credit Suisse Group. "You need to be a top-three player to make a sustainable profit." Acer had sales of \$11.1 billion in 2006 and profits of \$338 million, estimates Credit Suisse.

THE UN-DELL

ACER HAS BEEN gaining ground thanks to low-cost machines and unconventional distribution. It shuns direct sales, instead selling only through distributors and outsourcing all production to factories in China. Acer has also been the driving force in price wars that have taken a toll on former No.1 Dell Inc. Although Acer has some premium offerings, such as its Ferrari line of sleek machines in red racing stripes, it typically underprices competitors by 5% to 10%.

Even so, Acer usually offers retailers a bigger chunk of the selling price than rivals do.

The strategy is working: Sales have more than doubled since 2003, though it has cut Acer's profit

margin to about 2%, or less than half of HP or Dell.

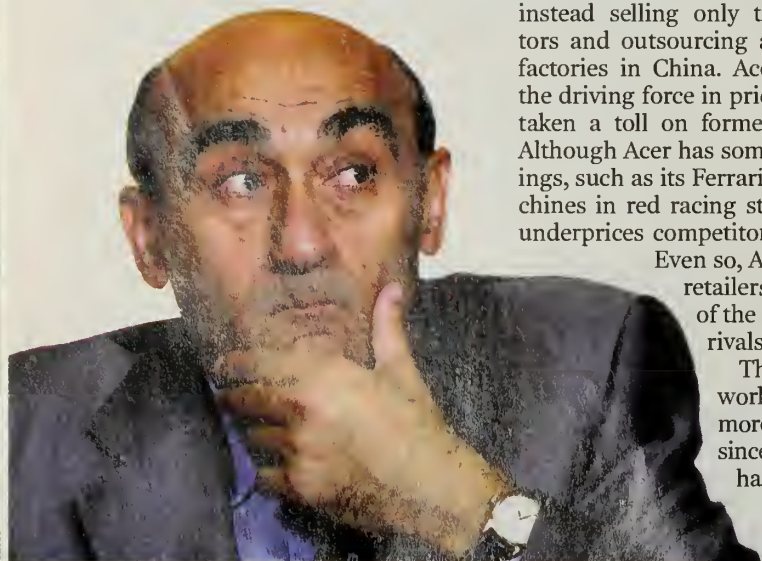
To keep the momentum going, Acer must expand beyond its stronghold in Europe. There, it's the market leader in laptops and No.3 overall, thanks to Lanci. A 16-year veteran of Texas Instruments Inc.'s PC business, which he acquired in 1997, Lanci headed Acer's European operations before becoming president in 2005. Now Acer is taking fight directly to China, where it is No.1. In 2005, Acer revamped its operation on the mainland, halving head count and outsourcing distribution.

Acer also hopes to improve its position in the U.S., where it has just 1% of the market. The company sells only notebooks to small businesses among large corporate customers, "don't have the credibility" needed, Elsa Opitz, research manager at IHS London. Acer has raised its profile in the U.S. consumers over the past two years through deals to sell its wares at Target, CompUSA, and Circuit City—venues that could ultimately pay off with big gains, says U.S. sales chief Mark Wang. "More of a presence in U.S. retail," he says, "will inevitably lead to better recognition." ■

—With Olga Kharif in Portland

BusinessWeek.com

ONLINE: For a slide show of Acer's models, please visit www.businessweek.com/extras.





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Beyond The Green Corporation

Imagine a world in which eco-friendly
and socially responsible practices actually
help a company's bottom line.

It's closer than you think.

By Pete Engardio

UNDER CONVENTIONAL NOTIONS OF HOW TO RUN A CONglomerate like Unilever, CEO Patrick Cescau should wake up each morning with a laserlike focus: how to sell more soap and shampoo than Procter & Gamble Co. But ask Cescau about the \$52 billion Dutch-British giant's biggest strategic challenges for the 21st century, and the conversation roams from water-deprived villages in Africa to the planet's warming climate.

The world is Unilever's laboratory. In Brazil, the company operates a free community laundry in a São Paulo slum, pro-

vides financing to help tomato growers convert to eco-friendly "drip" irrigation, and recycles 17 tons of waste annually at its toothpaste factory. Unilever funds a floating hospital that offers free medical care in Bangladesh, a nation with just 20 doctors for every 10,000 people. In Ghana, it teaches palm oil producers to reuse plant waste while providing potable water to deprived communities. In India, Unilever staff help thousands of women in remote villages start micro-enterprises. And in response to green activists, the company discloses how it



carbon dioxide and hazardous waste its factories spew out around the world.

As Cescau sees it, helping such nations wrestle with poverty, water scarcity, and the effects of climate change is vital to staying competitive in coming decades. Some 40% of the company's sales and most of its growth now take place in developing nations. Unilever food products account for roughly 10% of the world's crops of tea and 30% of all spinach. It is also one of the world's biggest buyers of fish. As environmental regulations grow tighter around the world, Unilever must invest in green technologies or its leadership in packaged foods, soaps, and other goods could be imperiled. "You can't ignore the impact your company has on the community and environment," Cescau says. CEOs used to frame thoughts like these in the context of moral responsibility, he adds. But now, "it's also about growth

sus·tain·a·bil·i·ty

Meeting humanity's needs without harming future generations. It's an old ideal, broadly endorsed by economic development experts, environmentalists, and human rights activists, but formerly too touchy-feely for many American business leaders. Now, however, it's at the top of the agenda of growing numbers of U.S. CEOs, especially young ones.

and innovation. In the future, it will be the only way to do business."

A remarkable number of companies have begun to commit themselves to the same kind of sustainability goals. Cescau has pinpointed, even in the most obsessed America. For years, the "sustainability" has carried a lot of baggage. Put simply, it's about meeting humanity's needs without harming future generations. It was a favorite of environmentalists, human rights activists, and conservationists.

But to many U.S. business leaders, sustainability meant higher costs and smacked of earnest U.N. corporate responsibility conferences and the utopian idealism of Western Europe. Now, sustainability is "right at the top of the agenda" of more U.S. CEOs, especially young ones, says McKinsey Global Institute Chairman Lenny Mendonca.

More Than PR

YOU CAN TELL SOMETHING is up just wading through the luminous sustainability reports of most big corporations posted on their Web sites. These lay out efforts to cut toxic emissions,

create eco-friendly products, help the poor, and cooperate with nonprofit groups. About a century as five years ago, such reports—if they appeared at all—were usually transparent efforts to polish the corporate image. Now, there's a more sophisticated understanding that environmental and social practices can yield strategic advantages in an interconnected world of shifting customer loyalties and regulatory regimes.

Embracing sustainability can help avert costly setbacks from environmental disasters, political protests, and human rights workplace abuses—the kinds of debacles suffered by Royal Dutch Shell PLC in Nigeria and Unocal in Burma. "Nobody has an idea when such events can hit a balance sheet," says Matthew J. Kiernan, CEO of Innovest Strategic Value Advisors. Innovest is a international research and advisory firm whose clients include large institutional investors. It supplied the data for this *BusinessWeek* special Report and prepared a list of the world's 100 most sustainable corporations, to be presented at the Jan. 24-28 World Economic Forum in Davos, Switzerland.

The roster of advocates includes Jeffrey Pfeffer, CEO of General Electric Co., who is betting billions to position GE as a leader in innovation in everything from wind power



UNILEVER To improve people's lives—and promote its soap and detergent—the company sponsors a floating hospital in Bangladesh and free laundromats in Br

Who's Doing Well by Doing Good

SOME LEADERS What does it mean to say a company, its products, or its processes are "sustainable"? Here is a list of top-rated companies by industry:

AUTOMOBILES		COMMUNICATIONS EQUIPMENT	
TOYOTA	The maker of the top-selling Prius hybrid leads in developing efficient gas-electric vehicles.	NOKIA	Makes phones for handicapped and low-income consumers. A leader in phasing out toxic materials.
RENAULT	Integrates sustainability throughout organization. Has fuel-efficient cars and factories.	ERICSSON	Eco-friendly initiatives include wind- and fuel-cell-powered telecom systems in Nigerian villages.
VOLKSWAGEN	A market leader in small cars and clean diesel technologies.	MOTOROLA	Good disclosure of environmental data. Takes back used equipment in Mexico, U.S., and Europe.
COMPUTERS & PERIPHERALS		FINANCIAL SERVICES	
HEWLETT-PACKARD	Despite board turmoil, the company rates high on ecological standards and digital tech for the poor.	ABN AMRO	Involved in carbon-emissions trading. Finances everything from micro enterprises to biomass fuels.
SHIBATA	At forefront of developing eco-efficient products, such as fuel cells for notebook PC batteries.	HSBC	Lending guidelines for forestry, freshwater, and chemical sectors factor in social, ecological risks.
DELL	Among the first U.S. PC makers to take hardware back from consumers and recycle it for free.	ING	Weights sustainability in project finance. Helps developing nations improve financial institutions.
HEALTH CARE		HOUSEHOLD DURABLES	
RESENIUS MEDICAL CARE	Discloses costs of its patient treatment in terms of energy and water use and waste generated.	PHILIPS ELECTRONICS	Top innovator of energy-saving appliances, lighting, and medical gear and goods for developing world.
MS HEALTH	Places unusual emphasis on environmental issues in its global health consulting work.	SONY	Is ahead on green issues and ensuring quality, safety, and labor standards of global suppliers.
QUEST DIAGNOSTICS	Has diversity program promoting businesses owned by minorities, women, and veterans.	MATSUSHITA ELECTRIC	State-of-the-art green products. Eliminated 96% of the most toxic substances in its global operations.
OIL & GAS		PHARMACEUTICALS	
ROYAL DUTCH SHELL	Since Nigerian human rights woes in '90s, leads in community relations. Invests in wind and solar.	ROCHE	Committed to improving access to medicine in poor nations. Invests in drug research for Third World.
ORSK HYDRO	Cut greenhouse gas emissions 32% since 1990. Strong in assessing social, environmental impact.	NOVO NORDISK	Spearheads efforts in diseases like leprosy and bird flu and is a leading player in lower-cost generics.
UNCOR ENERGY	Ties with aboriginals help it deal with social and ecological issues in Canada's far north.	GLAXO-SMITHKLINE	One of few pharmas to devote R&D to malaria and TB. First to offer AIDS drugs at cost.
RETAIL		UTILITIES	
MARKS & SPENCER	Buys local product to cut transit costs and fuel use. Good wages and benefits help retain staff.	FPL	Largest U.S. solar generator. Has 40% of wind-power capacity. Strong shareholder relations.
HOME RETAIL GROUP	High overall corporate responsibility standards have led to strong consumer and staff loyalty.	IBERDROLA	Since Scottish Power takeover, renewable energy accounts for 17% of capacity. Wants that to grow.
AEON	Environmental accounting has saved \$5.6 million. Good employee policies in China and SE Asia.	SCOTTISH & SOUTHERN	Aggressively discloses environmental risk, including air pollution and climate change.

SOME LAGGARDS Concentrating on the bottom line makes companies postpone important changes. It can also lead to poor public relations. Here are a few companies that received lower marks:

LEGHENY ENERGY Reliance on coal poses risk if U.S. passes greenhouse gas rules.

BANK OF CHINA Hit by recent corruption cases, but bank says it has since improved governance.

GENERAL MOTORS Trails Toyota and Honda in fuel-efficient cars. High reliance on SUVs.

NINTENDO Slow to grapple with how emerging environmental, safety, and labor standards will affect offshore suppliers.

PETROCHINA Lacks transparent environmental programs. Safety record includes fatal gas leak and benzene plant explosion.

SURGUTNEFTEGAZ Plagued by shareholder suits. Lacks public environmental policy.

WAL-MART The mass retailer has made great strides with ambitious green initiatives (page 57), but the company's image remains tarnished by criticisms of labor and offshore sourcing practices.

9

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HUMAN

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SEEING THE FUNDAMENTAL IN THE ELEMENTAL. There is nothing more

elemental than chemistry. It is the basic story of life. And when that story includes



the Human Element, chemistry gets down to the fundamental work of solving

human problems. Health. Housing. Food. Water. The essentials of life



all made better by looking at the world through the eyes of the Human Element.

hybrid engines. Wal-Mart Stores Inc., long assailed for its labor and global sourcing practices, has made a series of high-profile promises to slash energy use overall, from its stores to its vast trucking fleets, and purchase more electricity derived from renewable sources. GlaxoSmithKline discovered that, by investing to develop drugs for poor nations, it can work more effectively with those governments to make sure its patents are protected. Dow Chemical Co. is increasing R&D in products such as roof tiles that

CEOs and boards that they pay off. Few Wall Street analysts, for example, have tried to assess how much damage Wal-Mart's reputation for poor labor and environmental practices has done to the stock price. But New York's Communications Consortium Worldwide (CCW), which studies issues such as reputation in stark dollars and cents, calculates that if Wal-Mart had a reputation like that of rival Target Corp., its stock would be worth 8.4% more, adding \$16 billion in market capitalization.



deliver solar power to buildings and water treatment technologies for regions short of clean water. "There is 100% overlap between our business drivers and social and environmental interests," says Dow CEO Andrew N. Liveris.

Striking that balance is not easy. Many noble efforts fail because they are poorly executed or never made sense to begin with. "If there's no connection to a company's business, it doesn't have much leverage to make an impact," says Harvard University business guru Michael Porter. Sustainability can be a hard proposition for investors, too. Decades of experience show that it's risky to pick stocks based mainly on a company's long-term environmental or social-responsibility targets.

Nevertheless, new sets of metrics, which Innovest and others designed to measure sustainability efforts, have helped convince

PETROCHINA Mishaps include a gas well eruption in 2003 in southwest China that killed 243 people

Serious money is lining up behind the sustainability agenda. Assets of mutual funds that are designed to invest in companies meeting social responsibility criteria have swelled from \$1 billion in 1995 to \$178 billion in 2005, estimates trade association Social Investment Forum. Boston State Street Global Advisors handles \$77 billion in such investments. And institutions with \$4 trillion in assets, including charitable and government pension funds in Europe and states such as California, pledge to weigh sustainability factors in investment decisions.

Why the sudden urgency? A growing clout of watchdog groups is making savvy use of the Internet as one factor. New environmental regulations also play a powerful role. Electronics manufacturers slow down their factories and process off toxic materials, for example, could be at a serious disadvantage as Europe adopts additional, stringent restrictions. American energy and utility companies that cut fossil fuel reliance could be hurt if Washington joins the rest of the

industrialized world in ordering curbs on greenhouse emissions. Such developments help explain why Exxon Corp., long opposed to linking government policies with global warming theories, is now taking part in meetings to figure out what the U.S. should do to cut emissions.

Investors who think about these issues obviously have long time horizons. But they encounter knotty problems when they try to peer beyond the next quarter's results to a future

soul-stirring

mind-numbing

WAL-MART STORES

Big Strides to Become The Jolly Green Giant

COMPANIES ADOPT GREEN strategies for different reasons. By CEO H. Lee Scott Jr.'s own admission, the changeover at Wal-Mart Stores Inc. began in self-defense. Surveys showed that the retail giant's image had taken such a beating that no customers were staying away. So Scott huddled with environmentalists, hired consultants, and came up with plans that astonished even some activists. He vowed to use 100% renewable energy, drastically reduce waste through recycling, and sell "sustainable" products that are more environmentally friendly. "Wal-Mart is implementing one of the most aggressive sustainability strategies I have ever seen," says Frank Dixon, adviser to both Innovest Strategic Value Advisors and Wal-Mart. Although the effort began as image-enhancing, "we started seeing it as a business strategy," Scott explains. Cutting energy use is saving money, and consumers appreciate Wal-Mart's forays into organic cotton products and coffee certified to have



earned farm workers a decent wage.

Switching stores to more efficient bulbs and adding skylights for natural light has trimmed Wal-Mart's electricity bill by 17% since 2002. Using less packaging on house brand toys will save \$2.4 million annually in shipping costs. Even Wal-Mart's push to slash America's electricity use—and thus greenhouse gas emissions—by selling 100

million compact fluorescent bulbs a year has a bottom-line benefit. Customers would save \$3 billion, "and the expectation is that those savings would come back in terms of purchases," says Brown University ecology professor Steven Hamburg.

Whatever Wal-Mart's motivations, many environmentalists are thrilled with the company's plans because of its massive clout. "They can have more impact than a bunch of smaller, more noble players," explains one. Wal-Mart's commitment to sell fish certified as caught in sustainable fisheries is doing more to protect stocks than government rules could, suggests Manish Kumar, CEO of The Fishin' Co., a major supplier: "It has brought an about-face in the mindset of the entire supply chain."

Wal-Mart still faces an uphill battle. A 2005 Innovest report on the company gave it the lowest rating. An update to that report will rank it higher, but far from the top. "Their failings on the social side are so strong," says Innovest analyst Elizabeth Lipton. Wal-Mart responds that its labor and health-care policies are little different from those of competitors, and that low employee costs help keep prices down.

Yet the labor issues may be difficult to lay to rest. And even on the environmental front, "they are certainly not sustainable now," says Natural Resources Defense Council President Frances Beinecke. "Their goals are bold, but they have just begun."

—By John Carey

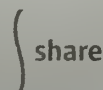
the road. Corporations disclose the value of physical assets and investments in equipment and property. But U.S. regulators don't require them to quantify environmental, social, or labor practices. Accountants call such squishy factors "intangibles." These items aren't found on a corporate balance sheet, yet can be powerful indicators of future performance. Wal-Mart is at the leading edge of understanding and acting on megatrends taking shape in key markets, this

could constitute a valuable intangible asset. By being the first fast-food chain to stop using unhealthy trans fats, Wendy's International Inc. may have a competitive edge now that New York City has banned the additives in restaurants. McDonald's Corp., which failed to do so, could have a future problem.

Rising investor demand for information on sustainability has spurred a flood of new research. Goldman Sachs, Deutsche Bank Securities, UBS, Citigroup, Morgan Stanley, and other

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brokerages have formed dedicated teams assessing how companies are affected by everything from climate change and social pressures in emerging markets to governance records. "The difference in interest between three years ago and now is extraordinary," says former Goldman Sachs Asset Management CEO David Blood, who heads the Enhanced Analytics Initiative, a research effort on intangibles by 22 brokerages. He also leads Generation Investment Management, co-founded in 2004 with former Vice-President Al Gore, which uses sustainability as an investment criterion.

Perhaps the most ambitious effort is by Innovest, founded in 1995 by Kiernan, a former KPMG senior partner. Besides conventional financial performance metrics, Innovest studies 120 different factors, such as energy use, health and safety records, litigation, employee practices, regulatory history, and management systems for dealing with supplier problems. It uses these measures to assign grades ranging from AAA to CCC, much like a bond rating, to 2,200 listed companies. Companies on the Global 100 list on *BusinessWeek's* Web site include Nokia Corp. and Ericsson, which excel at tailoring products for developing nations, and banks such as HSBC Holdings and ABN-Amro that study the environmental impact of projects they help finance.

Some of Innovest's conclusions are counterintuitive. Hewlett-Packard and Dell both rate AAA, for example; market darling Apple gets a middling BBB on the grounds of weaker oversight of offshore factories and lack of a "clear environmental business strategy." An Apple spokesman contests that it is

a laggard, citing the company's leadership in energy-efficient products and in cutting toxic substances. Then there's Corp. vs. Nintendo. Wall Street loves the latter for a host of reasons, not least that its Wii video game system, the first to let users simulate actions such as swinging a sword or tennis racket, was a Christmas blockbuster. Sony, meanwhile, has a famously dysfunctional home electronics arm, and was embarrassed by exploding laptop batteries and long delays in bringing out its PlayStation 3 game console. Nintendo's stock has more than tripled in three years; Sony's has languished.

Weighing the Efforts

VIEWED THROUGH THE LENS OF SUSTAINABILITY, however, Sony looks like the better bet. It is an industry leader in developing energy-efficient appliances. It also learned from a fiasco, when illegal cadmium was found in PlayStation cables bought from outside suppliers. That cost Sony \$85 million, says Hidemi Tomita, Sony's corporate responsibility general manager. Now, Sony has a whole corporate infrastructure for controlling its vast supplier network, he says, to avert or quickly fix problems. Nintendo, a smaller Kyoto-based company focused on games, shows less evidence of the same management systems needed to cope with sudden regulatory shifts or supplier problems, says Innovest. A Nintendo spokesman says it meets all environmental rules and is "always reviewing

TOYOTA

How the Hybrid Race Went to the Swift

TOYOTA NOT ONLY MAKES MORE profit than any other automaker but also enjoys the best reputation for producing clean-running, fuel-efficient vehicles. Its gas-electric hybrid Prius is a public relations juggernaut and the centerpiece of a lineup with an average fuel efficiency of 28.9 miles per gallon, second only to Honda's fleet average. General Motors Corp. and Ford Motor Co., which sell more pickup trucks and SUVs than Toyota, lag behind in fuel economy, with averages of 24.6 and 24.1 mpg, respectively, for their fleets.

As Toyota prepares to motor past Ford as the world's second-largest carmaker, it has become a textbook case on how a green reputation delivers a competitive edge. In the five years since the Prius' U.S. debut, Toyota's brand value has surged by 47%, to \$28 billion, according to Interbrand. In the same period, Ford has been beset with numerous troubles, including a failure to



meet its goals for SUV mileage gains or to exploit its well-regarded Escape hybrid. Its brand value fell 70%, to \$11 billion.

How did Detroit blow it? More than anything, through inertia. For 20 years, GM and Ford earned outsized profits on oversize trucks and SUVs. And following

the infamous failure of GM's EV1 electric car, a high-tech, high-cost econobox seemed like anything but a good bet.

Detroit simply didn't see the potential for Toyota's odd little electric-gas car when the Prius made its debut in Japan 10 years ago. When energy prices spiked, Toyota was ready with a high-tech offering that many consumers embraced. Today, even if hybrids aren't exactly cost-effective, consumers keep buying them. From a few thousand sold in the U.S. in 2000, Toyota expects to move 250,000 hybrids next year. "We didn't appreciate the image value of hybrids," concedes GM's research and development chief, Larry Burns. "We missed that."

There's an ironic side to all this. In the U.S., GM sells more models that get more than 30 mpg than any other carmaker. And two Ford SUVs, the Expedition and Explorer, go farther on a gallon of gas than do Toyota's like-size models. "Toyota's fan for hybrids allows consumers to believe every one of its vehicles is the most fuel-efficient in its category—even if it isn't," says marketing consultant Dan Gorrell.

Now, GM has announced a plug-in Saturn hybrid and an advanced plug-in electric Chevy car. Both come ahead of similar moves from Toyota. But GM has also set and missed such goals in the past. The value of green, it seems, only accrues when the rubber meets the road.

—By David Kiley

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and considering" the merits of new global sustainability guidelines.

Here's another Rorschach test. Which is the best investment: ExxonMobil, BP, or PetroChina? Exxon, one of the best-performing energy biggies of the past five years, seems like the obvious stock pick. PetroChina Co. is riskier but also alluring. It's a prime supplier of fuel to booming China, has seen revenues and profits rocket, and has been a hot stock for two years. Analyst Shahreza Yusof of Aberdeen Asset Management PLC rates the company a buy. Because of its access to China's market and new reserves, he writes, one day it will be as big as today's major oil giants—"if not bigger."

By contrast, BP seems to disprove the sustainability thesis altogether. CEO John Browne has preached environmentalism for a decade, and BP consistently ranked atop most sustainability indexes. Yet in the past two years it has been hit with a refinery explosion that killed 15 in Texas, a fine for safety violations at a refinery in Ohio, a major oil pipeline leak in Alaska, and a U.S. Justice Dept. probe into suspected manipulation of oil prices. Browne has recently announced his retirement. BP's shares have slid 10% since late April. Exxon's are up around 12%.



DOW CHEMICAL Its Styrofoam helps insulate a Habitat for Humanity house

Innovest still rates BP a 5 while labeling Exxon a risk. And PetroChina? Innovest a CCC. Here's why: BP wins for plowing \$8 billion into alternative energies to diversify away from oil and engages communities and environmental groups. Exxon has done less to curb greenhouse emissions and promote renewable energy and has big projects in spots like Chad. "I would not buy Exxon as a bigger long-term investment," says Innovest's Kiernan. China is easier to justify. Because of its safety record: A gas well explosion killed 243 people in another fatal explosion in Texas that spewed toxic benzene into the air, leaving millions temporarily

out of water. PetroChina has been slow to invest in alternative energies, Innovest says, and its parent company has big bets in the U.S.

Do Innovest's metrics make a reliable guide for investors? Dozens of studies have looked for direct relationships between a company's social and environmental practices and its financial performance. So far the results are mixed, and Innovest admits Innovest can't prove a causal link. That's little

GLAXOSMITHKLINE

Getting AIDS Drugs To More Sick People

WHEN JEAN-PIERRE GARNIER took over as CEO of GlaxoSmithKline seven years ago, the company's reputation on corporate social responsibility was at its nadir. As part of a coalition of 39 pharmaceutical companies, the drugmaker was suing Nelson Mandela's South African government for voiding patents on prescription drugs. Mandela's top priority was giving desperately sick patients access to HIV treatments, and GSK—the world's largest supplier—was standing in the way. "It was a public relations disaster," Garnier concedes.

The experience convinced Garnier that GSK should lead the crusade to improve access to medicine. In 2001, GSK became the first major drugmaker to sell its AIDS medicines at cost in 100 countries worldwide. And it has granted eight licenses to local companies to produce generic versions of these medicines.



In fact, GSK sells 90% of its vaccines, in volume terms, at not-for-profit prices to customers in the developing world. In 2005, it set a new paradigm in the vaccine industry. It chose Mexico over other, wealthier nations as the launch pad for Rotarix, a new vaccine against

gastrointestinal rotavirus. "We wanted to get the vaccine to the children who need it most," Garnier explains.

Creating medicines for the Third World while still posting a profit required fancy financial footwork. GSK has formed 14 different partnerships with the World Health Organization and other nongovernmental bodies, and with philanthropies such as the Bill & Melinda Gates Foundation. The programs provided funding for research into two different HIV vaccines, new treatments for tuberculosis, and a pediatric vaccine against malaria. In the latter case, a collaboration with the Gates Foundation and a group called the Malaria Vaccine Initiative led to a vaccine that provides a minimum of 18 months of protection against malaria. It could be on the market within four years. "The commitment [of GSK] to developing a malaria vaccine is outstanding," says Dr. Tore Godal, the former head of the Global Alliance for Vaccines & Immunization (GAVI).

Garnier says efforts such as these give the company several advantages over its rivals. Top scientists are drawn to GSK because they want their research to make a difference. Doing good, and being admired for it, also boosts general morale at the company, he says. "This creates a more aligned and engaged workforce, which helps us outperform our competitors."

—By Kerry Ca

recommends Windows® XP Professional



Departures					Arrivals				
CITY	FLIGHT NO	TIME	GATE	STATUS	CITY	FLIGHT NO	TIME	GATE	STATUS
TOKYO	2195	6:25	A11	ON TIME	HAN LA	715	6:10	A1	ON TIME
SHANGHAI	2272	6:50	B10	ON TIME	ABUL	216	6:35	C2	ON TIME
HONG KONG	756	6:45	F45	ON TIME	SCON	222	6:45	F1	ON TIME
MEXICO CITY	701	7:50	A8	ON TIME	BANGKOK	1075	4:5	A	ON TIME
SAO PAULO	717	7:55	A10	ON TIME	MADRID	2072	6:55	B2	ON TIME
BUENOS AIRES	727	8:15	C18	ON TIME	FRANKFURT	712	6:10	A11	ON TIME
CAIRO	765	8:15	B1	ON TIME	SYDNEY	729	6:30	A10	ON TIME
DUBLIN	2123	9:01	A7	ON TIME	SINGAPORE	2190	6:00	A1	ON TIME
LONDON	201	9:03	A2	ON TIME	TAIPEI	711	9:15	A3	ON TIME
ZURICH	26	9:45	C8	ON TIME	KUALA LUMPUR	725	6:55	B18	ON TIME
ROME	516	10:15	C17	ON TIME	DUBAI	511	10:30	A	ON TIME
PARIS	2191	10:40	B1	ON TIME	BEIJING	615	1:50	A16	ON TIME
COPENHAGEN	227	11:05	B11	ON TIME	HAMBURG	762	11:00	C25	ON TIME
NEW YORK CITY	811	11:50	A	ON TIME	MELBOURNE	725	10:45	C9	ON TIME
SAN FRANCISCO	611	11:05	A14	ON TIME	GENEVA	714	1:00	A8	ON TIME
VANCOUVER	2112	11:30	B12	ON TIME	STOCKHOLM	501	1:45	C16	ON TIME
TORONTO	1872	1:45	C23	ON TIME	ST. PETERSBURG	753	1:55	B1	ON TIME
SINGAPORE	252	2:02	C20	ON TIME	OTTAWA	2372	1:30	A7	ON TIME
DELHI	515	2:15	A4	ON TIME	MUMBAI	2193	1:55	A2	ON TIME
ATHENS	711	3:00	B2	ON TIME	SEOUL	210	1:11	C8	ON TIME

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Staples

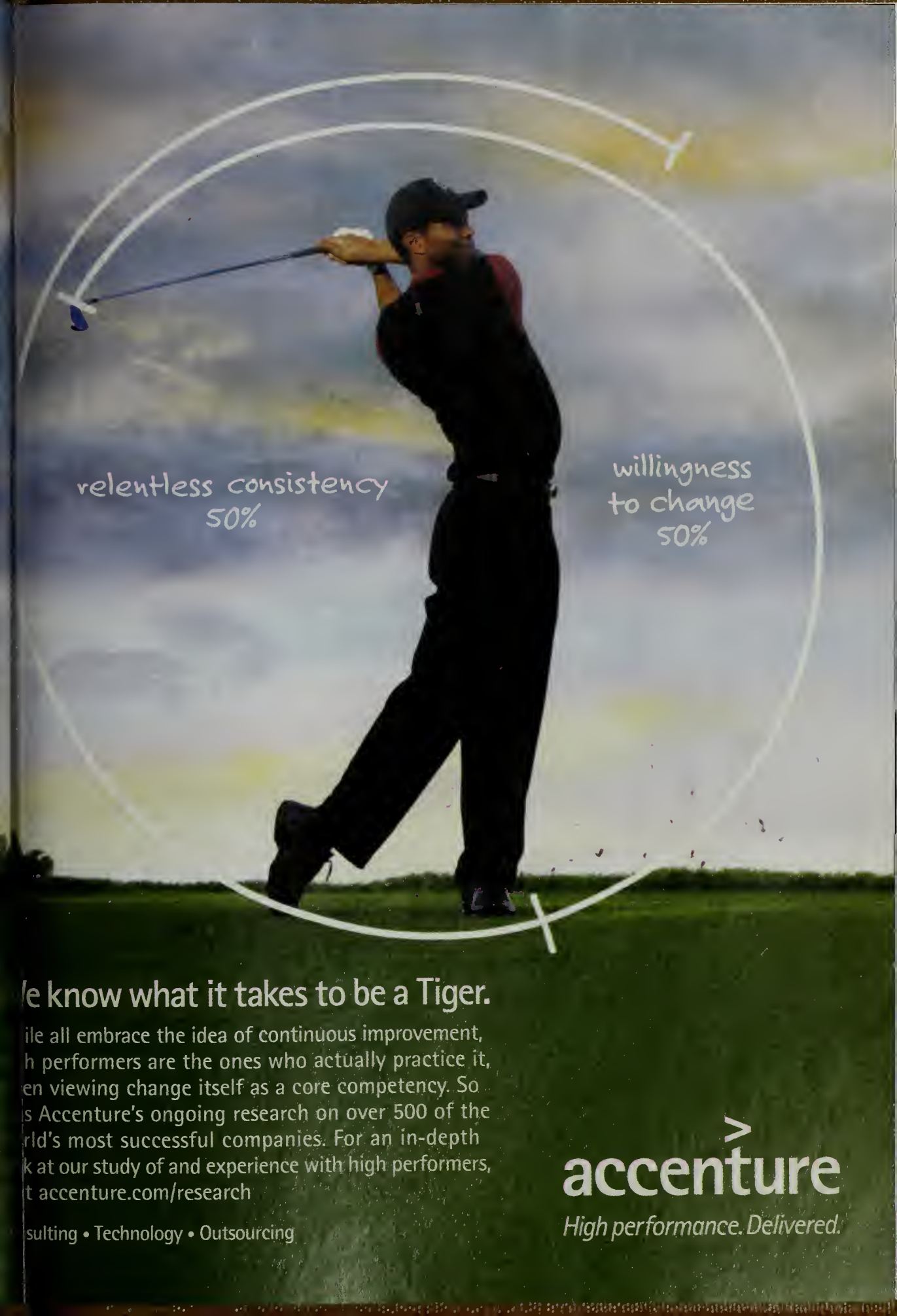
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A photograph of Tiger Woods in mid-swing on a golf course. A large, thin white circle is drawn around him, with a small white crosshair at the top right and bottom right, suggesting a circular path or motion. The background is a cloudy sky.

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willingness
to change
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portfolio managers who must post good numbers by yearend. "The crux of the problem is that we are looking at things from the long term, but we're still under short-term review from our clients," says William H. Page, who oversees socially responsible investing for State Street Global Advisors.

Talking a Good Fight

YET KIERNAN AND MANY OTHER experts maintain sustainability factors are good proxies of management quality. "They show that companies tend to be more strategic, nimble, and better equipped to compete in the complex, high-velocity global environment," Kiernan explains. That also is the logic behind Goldman Sachs's intangibles research. In its thick annual assessments of global energy and mining companies, for example, it ranks companies on the basis of sustainability factors, financial returns, and access to new resource reserves. Top-ranking companies, such as British Gas, Shell, and Brazil's Petrobras, are leaders in all three categories. For the past two years, the stocks of elite companies on its list bested their industry peers by more than 5%—while laggards underperformed, Goldman says.

Still, BP's woeful performance highlights a serious caveat to the corporate responsibility crusade. Companies that talk the most about sustainability aren't always the best at executing. Ford Motor Co. is another case in point. Former CEO William C. Ford Jr. has championed green causes for years. He famously spent \$2 billion overhauling the sprawling River Rouge (Mich.) complex, putting on a 10-acre grass roof to capture rainwater. Ford also donated \$25 million to Conservation International for an environmental center.

But Ford was flat-footed in the area most important to its business: It kept churning out gas-guzzling SUVs and pickups. "Having a green factory was not Ford's core issue. It was fuel economy," says Andrew S. Winston, director of a Yale University corporate environmental strategy project and co-author of the book *Green to Gold*.

The corporate responsibility field is littered with lofty intentions that don't pay off. As a result, many CEOs are unsure what to do exactly. In a recent McKinsey & Co. study of 1,144 top global executives, 79% predicted at least some responsibility for dealing with future social and political issues would fall on corporations. Three of four said such issues should be addressed by the CEO. But only 3% said they do a good job dealing with social pressures. "This is uncomfortable territory because most CEOs have not been trained to sense or react to the broader landscape," says McKinsey's Mendonca. "For the first time, they are expected to be statesmen as much as they are functional business leaders." Adding to the complexity, says Harvard's Porter,



PHILIPS The company is helping make hospitals a more positive experience for children in developing nations

each company must custom-design initiatives that fit its own objectives.

Dow Chemical is looking at the big picture. It sees a market in the need for low-cost housing and is developing technologies such as a friendly Styrofoam used for walls. CEO John P. Doe also cites global water scarcity as a field in

Dow can "marry planetary issues with market opportunity. U.N. figures 1.2 billion people lack access to clean water. Dow financial solutions could help 300 million of them. That translates into up to \$3 billion in sales for Dow, which has a portfolio of cutting-edge systems for filtering minute contaminants from water. To reach the poor, Dow is working with foundations and the U.N. to raise funds for projects.

Philips Electronics also is building strategies around megatrends. By 2050, the U.N. predicts, 85% of people will live in developing nations. But shortages of health care are acute. Among Philips' many projects are medical vans that reach remote villages, allowing urban doctors to diagnose and treat patients via satellite. Philips has also developed low-cost water-purification technology and a smokeless wood-burning stove that could reduce the 1.6 million deaths annually from pulmonary diseases linked to cooking smoke. "For us, sustainability is a business imperative," says Philips Procurement Officer Barbara Kux, who chairs a sustainability board that includes managers from all business units.

Such laudable efforts, even if successful, may not help investors make their numbers next quarter. But amid turbulent global challenges, they could help investors sort long-term survivors from the dinosaurs. ■

—With Kerry Capell in London, John Capell in Washington, and Kenji Hall in

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Dr. Z's Waning Credibility

Dieter Zetsche, charged with smoothing the Chrysler-Mercedes alliance, has chalked up a decidedly mixed report card

BY DAVID KILEY

LAST FOURTH OF JULY weekend, Dieter Zetsche flew from Stuttgart to the sweltering Daytona Beach International Speedway in Florida to introduce Chrysler's "Dr. Z" ad campaign. It starred the DaimlerChrysler chairman in TV spots and a dedicated Web site as an all-knowing, German-accented wizard of the auto industry. The strategy was to communicate that Chrysler is backed up by the same Teutonic know-how and discipline that has long made Mercedes-Benz one of the world's most prestigious brands.

After NASCAR's Pepsi 400 race, in which

driver Kasey Kahne—driving a Dodge with Zetsche's face on the hood—disappointed by finishing 25th in a field of 43, Dr. Z flew to Indianapolis for a Formula One race. He was rooting for a pair of McLaren Mercedes F1s in vain: The two contenders smashed into each other 30 seconds after the green flag and failed to complete the first lap. "This isn't going according to the script," Zetsche quipped at the time.

Nothing much is following the script at Chrysler these days. In fact, the whole dramatic story of Zetsche's turnaround of the auto manufacturer, which he led from 2000 to 2005, is in rewrite. It once read as a tale of triumph dramatic enough to get Zetsche the top job at DaimlerChrysler,

a post he assumed on Jan. 1, 2000; now it seems a story of risky misadventures and missed opportunities. Though Chrysler boosted sales during his tenure by pushing far more vehicles on dealerships and rental fleets than the market demanded has been well documented. What is widely appreciated is the rest of Zetsche's inconsistent legacy. While Zetsche was ahead of General Motors Corp. and Ford Motor Corp. in downsizing, slaughtering 42,000 jobs and five assembly plants in five years, it is now clear that he did not cut nearly enough. And though Zetsche championed the Chrysler 300, perhaps the biggest mass-market design success of the last decade, the rest of his pro-



ARCHITECT Under Zetsche, Chrysler will need its second billion-dollar-plus restructuring in seven years

Morgan Stanley analyst Adam Jonas projects losses in 2007 of more than \$1 billion. All in all, the corrective restructuring charges and losses have wiped out all the paper gains Zetsche has posted at Chrysler since his arrival in 2000. Many investors are questioning whether Chrysler and Mercedes can ever prosper together. "We are in recovery mode again," said Zetsche at the North American International Auto Show in Detroit on Jan. 8.

No kidding. Chrysler's market share has fallen, from 14.5% when Zetsche took over to 12.9% last year. His profit target has been, and remains, a return on sales of 5%. Not only is that goal elusive, but Chrysler hasn't really come near it since 2000. In 2002, when the figure was reported to be 4.2%, its performance hinged on stuffing the sales pipeline with more vehicles than dealers could handle

(the company books revenue and profit when they ship to a dealer, not when the car is sold to a consumer). Chrysler had to take a \$1.25 billion charge in the second quarter of that year, in part to write down the decreased value of unsold inventory.

Even though Zetsche said in 2003 that the overproduction of vehicles "would never happen again," the same scenario did recur, only worse, at the end of 2005 and in 2006. The company took a \$1.45 billion charge in the third quarter to compensate for discounted inventories and production cuts. And it will likely spend billions more this year helping dealers move its already slow-selling models and covering the costs of cutting shifts at plants, since workers get paid whether they build cars or not. Leases for Chrysler

minivans are now going for \$2,000 down and less than \$50 a month on some lots. "It's a disgrace," says one frustrated dealer who asked not to be named.

That is hardly the only headache Zetsche has bequeathed to his successor, Chrysler Group CEO Tom Lasorda. Although Zetsche closed five plants in fairly short order, he didn't seize the opportunity to eliminate more excess vehicle assembly capacity in 2003 when the company last negotiated with the United Auto Workers. DaimlerChrysler then was still clinging to the original vision of the company as a "merger of equals" that was supposed to be yielding \$15 billion in profit by now. "The auto industry in the U.S. is forecasted to grow to some 20 million vehicles a year by the middle of the next decade, and we believe we'll need the plants," said Zetsche in 2003.

At the time, he optimistically predicted Chrysler's new models would do so well that the company would sell 3.2 million of them by 2010—up from the 2.7 million it sold in 2003. Chrysler finished 2006 at 2.69 million, with estimates that it pushed at least 400,000 to 500,000 vehicles to many rental car fleets and reluctant dealers. Chrysler currently has at least two plants too many to meet the demand for its vehicles, according to some critics. A spokesman acknowledges the carmaker has too much capacity, but wouldn't specify how many plants need to be cut.

DISGRUNTLED DEALERS

NOW, JUST AS he is poised to slash more jobs and at least one assembly plant, Lasorda is asking a reluctant UAW for big health-care givebacks it has already given to Ford and Chrysler. In exchange for the concessions, however, the union wants Chrysler to give it the go-ahead to organize Mercedes-Benz's nonunion assembly plant in Alabama, but Zetsche isn't warm to the idea. It's yet another example of the uneasy marriage of the two companies.

Although Zetsche has made sizeable gains in productivity and quality, he has hurt Chrysler by failing to update its antiquated system for ordering vehicles built at the plant to match consumer specifications. It sounds mundane, but dealers have been complaining for years that Chrysler does not send them vehicles with the equipment configurations they want. Instead, Chrysler's finance and procurement departments order a

Chrysler has at least two plants too many to meet the demand for its vehicles

as been iffy. During the Zetsche era at Chrysler, "the occasional success [has been] followed by a profit hiccup," says Albrecht Denninghoff, an analyst at Commerzbank in Frankfurt. "They go steps forward and one step back, forward one and two back." Chrysler spokesman Jason Fries defended Zetsche's record. Chrysler "back up on the lifts but not with blown tires. We don't have to change anything like we did six years ago." Fries, who did not comment for this article but was questioned by reporters on Jan. 8 at the Detroit auto show about Chrysler's management legacy, argued the company "is in much better shape than it was 10 years ago when you consider quality, productivity, and overseas growth." Fries also said the mess at Chrysler will necessitate a second billion-dollar-plus restructuring charge in seven years, to be announced in February, on top of the estimated \$1.2 billion loss for 2006.

mix of cars to be built at the factory to maximize profit rather than closely following consumer preferences. "No question, when we order the vehicles, it's not nearly as good as when the dealers order the cars," says Steve Landry, Chrysler's vice-president for sales and field operation, whose job it is to patch things up with franchisees. Dealers say they have Chrysler minivans, Dodge Ram pickups, and SUVs nosing close to \$40,000 without expected features like navigation systems. "This is basic to the car business," says Tom Libby of Power Information Network (PIN), which tracks sales data. Toyota Motor Corp., by contrast, meets with some franchisees weekly to fine-tune vehicle orders, Chrysler dealers say.

Both Zetsche and Lasorda deserve some blame for betting too heavily on gas-guzzling SUVs. The company has added the Chrysler Aspen and Jeep Commander SUVs to a product plan top-heavy with truck-based SUVs now falling out of fashion. Lasorda argues the company has no way of foreseeing the spike in gas prices.

The duo has also bet on risky designs. Yes, the Chrysler 300 brought to market in 2004 has been a runaway success, generating huge profits that have helped offset losses elsewhere. But overall Zetsche, billed as a design maven with keen balance sheet discipline, has chalked up a mixed report card. The Chrysler Crossfire coupe sports car was hailed as a great symbol of cooperation between Mercedes and Chrysler because it is built on the

Mercedes SLK platform. But it has sold so poorly that it takes eight months for dealers to move the car. The Dodge Magnum, hailed by Zetsche as the return of the European-styled sport wagon, has been a bust.

In 2003, says former ad chief Julie Roehm, a faction at Chrysler fought against developing the recently introduced Chrysler Sebring, lambasted by many critics for its ungainly styling. But the need to fill factories and achieve revenue targets wouldn't allow Chrysler to give up in a category where it faces two juggernauts: the Toyota Camry and Honda Accord sedan.

Worst of all, 10 new models Chrysler began launching last September, such as the Dodge Nitro and Sebring, which Lasorda is counting on to lift revenues and operating profit, are not being ordered by dealers in sufficient numbers because they're still trying to clear the old models from their lots. In mid-January, Chrysler met with dealers to pledge more financial support to lower sales prices, clear the excess, and hopefully make room for the new models. It now takes Chrysler and Dodge dealers nearly four months to sell a car, the worst rate in the industry. And that's while Chrysler offers the highest cash incentives in the business, \$3,500 per vehicle in customer cash. That's about \$850 per vehicle more than GM and

Orders of new models languish as dealers try to sell off old inventory

\$2,000 more than "The situation at Chrysler," says PIN's Libby. Chrysler's market has been in free fall ever since it spends big in incentives to create more niche models. "Chrysler is still building a 16% market share in a profitable share is probably around 10%," says Schroer, former sales and marketing chief.

That may not be enough to sustain Chrysler's viability with holders and the DaimlerChrysler supervisory board. Zetsche has acknowledged that the company's reliance on discounts has prevented it from making headway in improving the cash desirability of the Chrysler and Dodge brands over the past six years. Stantec Vision Inc., for example, last year that Chrysler and Dodge brands scored about 50% below the industry average for "trust."

The Dr. Z campaign has been rebuffed. Eight years since the merger, customers still don't know Chrysler owned by the same company that produces the Mercedes-Benz. They also think Zetsche was so smooth on screen to the point of head-butting a soccer ball perfectly in one take—that he was a doctor, not the real CEO. Seems Zetsche has to prove he's the real deal. ■

—With Gail Edmondson in Frankfurt

The Comeback That Wasn't

Chrysler's hollow turnaround under Dieter Zetsche

FINANCIAL Chrysler Group will lose about \$1.5 billion in 2006 on top of taking big charges in 2003 and 2006. Add in restructuring charges in 2007 and all of Zetsche's apparent profit gains since 2001 would be wiped out.

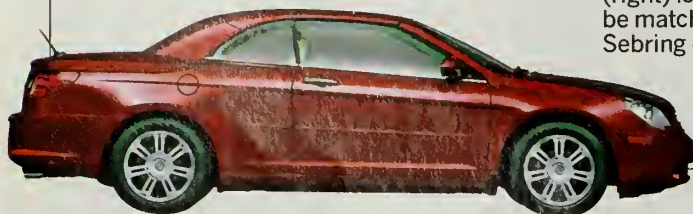
PRODUCTS Quality is way up. Chrysler 300, Jeep Wrangler, and the Stow-and-Go minivan are clear hits. But misses are mounting. Examples include Chrysler Crossfire, Dodge Magnum, Jeep Commander, Chrysler Aspen, and Dodge Durango. And the new Chrysler Sebring is surrounded by negative buzz.

MANUFACTURING Productivity is up. But Zetsche failed to close factories in the past in anticipation that he would need them when industry sales climb a decade from now. Meanwhile, Chrysler has been selling 35% of output to rental and other fleets and has filled storage lots with unwanted vehicles.

MARKETING Chrysler has the highest cash rebates and the slowest-selling vehicles at dealer lots in the industry. Residual values are falling, and its system for building cars with customized options is the worst in the industry, say dealers.

HITS AND MISSES

The success of the Chrysler 300 (right) is unlikely to be matched by the Sebring (left)

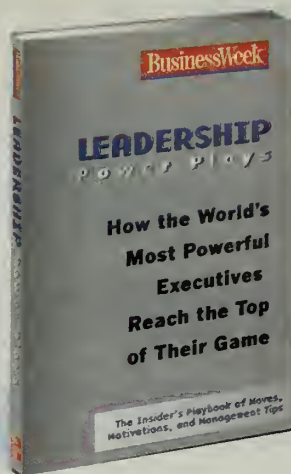




Hunger.



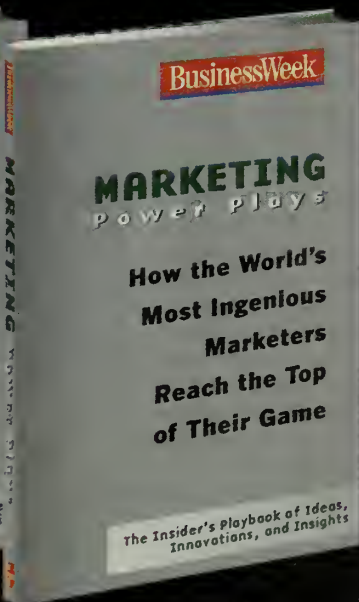
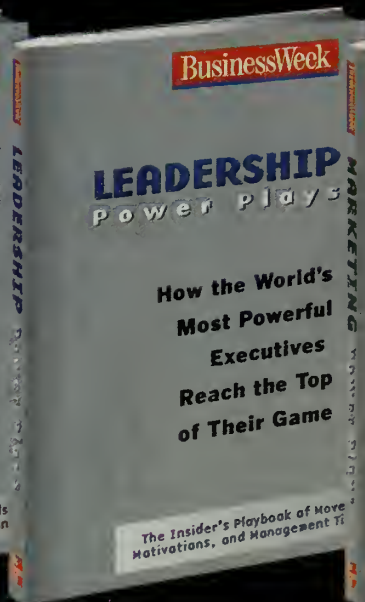
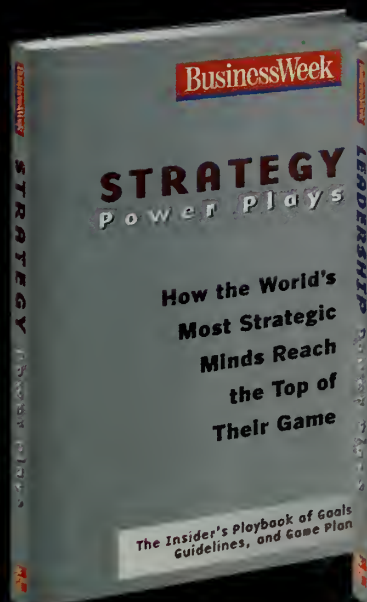
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Chanel's American In Paris

The design house's new global CEO takes aim at the next generation of luxury buyers

BY ROBERT BERNER

AT A MEETING WITH her leadership team in a sleek conference room high above New York, Maureen Chiquet, a slim 43-year-old with close-cropped hair, wears a dark couture jacket by legendary Chanel designer Karl Lagerfeld paired with superfine jeans and black Chanel boots. She and her team are strategizing about the launch of a new perfume. "Let's not be thinking about how big we can make this," says the new global head of one of the world's paramount—and most secretive—luxury brands, "but about how exclusive and special you can keep it."

It's a fair summary of Chiquet's strategy for the entire Chanel brand. In a transition planned since she joined Chanel in 2003, she rose from president of the Parisian company's U.S. division to the newly created global CEO post on Jan. 1. That's quite a trajectory for a St. Louis native who spent most of her career at Gap Inc. Her aim is just as ambitious: to take a strong brand to the next level by appealing to a new generation of luxury shoppers. To do so, she is employing a consumer focus unusual for luxury retailing and borrowing a few tricks from Gap. "Maureen has gotten us to perceive the brand from the opposite side of the counter because she is the ultimate Chanel consumer," says Renette Zimmerly, Chanel's U.S. director of creative services.

Chiquet has proved adept at working within a corporate culture that is profoundly French. Chanel's creative headquarters is still 31 rue Cambon, where Gabrielle "Coco" Chanel opened her

first Paris boutique in 1921. Chiquet has meshed with Chanel's creative egos, such as Lagerfeld, and its French owners, the Wertheimer family, whose two brothers are deeply involved in the business. They shun any public exposure and closely guard Chanel's financials. Analysts peg revenues at just over \$3 billion.

While granting *BusinessWeek* her first major interview, Chiquet declined to discuss the Wertheimers. The oldest brother, Alain, 58, is Chanel's chairman and has a corner office down the hall from Chiquet. His art collection of modern masters, including Roy Lichtenstein and Chuck Close, hangs in the halls.

Intense competition in the luxury business led the family to create a global leadership position. Larger established brands like Louis Vuitton and Gucci have deep-pocketed, publicly traded parents that own many hot, smaller brands

like upstart Bottega Veneta. These have been more centrally controlled than Chanel, whose five regional heads had a fair degree of autonomy, it is said. That's given the big players a more consistent global strategy. Now Chanel's presidents report directly to Chiquet. "It tightens the consistency and speed of decision-making," says L. Kopelman, Chanel's vice-chairman. "When you factor in a far more competitive world, this is the only way to go."

Chiquet seemed destined for this. She was the oldest of three sisters, and her father, a corporate lawyer, had a passion for French culture and spoke French fluently. By high school, speaking French was a major part of Chiquet's identity. At 16, she went to live with a French family in the town of Calvisson, near Nîmes, for several weeks. "I didn't want to have an American boyfriend," Chiquet says. "I wanted someone I knew I was American."

Chiquet attended Yale University, where she concentrated in literature, film and theater. Edward S. Lampert, the chairman of Sears Holdings, who dated Chiquet's best friend at Yale, says he saw a little of himself in how driven Chiquet was. "Even though she was friendly there was a seriousness about her," he says. Another classmate and close friend, Amanda Silver, points to one source of Chiquet's drive: "She had a strong relationship with her dad that propelled her to impress him."

BIO

Maureen Chiquet

How a devoted Francophile went from Gap trainee to head of a classic French brand



ROOTS Born Mar. 9, 1963, in St. Louis. Oldest of three daughters of Rochelle and Alan Popkin, a corporate lawyer.

EDUCATION Yale, BA in comparative literature, summa cum laude, 1985.

CAREER TRACK Rose from intern to brand manager in 3½ years at L'Oréal in Paris.

Joined Gap as a trainee; after 15 years was president of its Banana Republic division. Joined Chanel in 2003; became global CEO this January.

DAILY GRIND Rises at 5 a.m. at her Westchester County (N.Y.) home and does 45 minutes of e-mail while drinking multiple espressos. Does an hour of

cardio and a half-hour of weights before heading to the city.

FAVORITE THINGS

Collects contemporary American art, and furniture from the 1940s to 1970s. Travels extensively with husband, Antoine, and daughters Pauline, 14, and Camille, 10. They went on safari in Africa at Christmas.



he secretly dated a French man-Antoine Chiquet, in the marketing department. But when he was promoted to a new post in Asia she didn't want to go. They decided to quit, get married, and move to San Francisco without jobs. She landed as a trainee at Gap, and over the next 15 years rose to major merchandising positions at the company. At its Old World division, she was No. 2 under former CEO Penny Ming. Besides being the best assistant Ming had ever seen in identifying styles shoppers would want, her boss says, Chiquet knew every lever in running a business: "She could connect the pieces." She became president of Gap's Banana Republic unit in 2002, and when she took the Chanel job in 2003, to claim it, Chiquet beat out more

than 10 executives from the consumer-product, retailing, and luxury-goods industries. Kopelman says she had the best mix of business analytics combined with an ability to think creatively, a must to articulate the vision of Chanel's creative leaders. Chiquet's father negotiated her employment contract. "He was the best lawyer I knew," she quips.

BECOMING AU COURANT

AFTER NEARLY A year spent in Paris to learn Chanel's culture, Chiquet succeeded Kopelman as U.S. president in 2004 as part of the ascension plan. Her intent has been to build a more modern image for Chanel. In apparel, for example, Lagerfeld constantly reinvents the brand in his couture and ready-to-wear col-

NEW SPIN Chiquet's strategy includes selling Chanel in hipper boutiques

lections, Chiquet says. But that newness wasn't always conveyed in the sale of

\$5,000 Chanel jackets and \$2,000 handbags. Says Chiquet: "The risk of any great luxury brand that has its history in the past is that it can get dusty."

Like most designer-led luxury brands, Chanel traditionally pushed its product to market with little consumer input. Chiquet tripled the consumer research budget. In a meeting held in offices above Chanel's East 57th Street store, she and her team discuss a group they are targeting as a result of research: "new wealth." "More and more customers are acquiring wealth at earlier ages," Chiquet says, defining wealth as a net worth over \$1 million. These women have more cutting-edge fashion tastes, and find Chanel's austere boutiques intimidating and high-end department stores boring. Dominic DeVetta, head of Chanel's U.S. sales to third-party retailers, outlines a plan to reach this group by selling Chanel in independent, high-end boutiques. Chanel is starting with Jeffrey's in New York and Maxfield's in Los Angeles, stores with unique points of view that will put a new spin on the Chanel brand. "Jeffrey's is geek chic and Maxfield's is totally rock 'n' roll," DeVetta tells the team, getting laughs.

The plan isn't without risk. Chanel could anger big accounts Neiman Marcus and Saks Fifth Avenue. Nor do some shops want to sell Chanel: "Chanel is so last year," says Debi Greenberg, owner of swank independent Louis Boston.

It's not surprising, then, that Chiquet wants to make the brand even more exclusive. She has expanded a category of "ultra-luxe" goods, which includes \$26,000 alligator bags. But she's also applied a tactic from her Gap days called "must-haves." Chanel's U.S. boutiques used to buy the full assortment of collections in small amounts, which meant strong items would quickly run out. Now Chiquet encourages merchants to buy more of the items they think will be hot.

By all accounts, Chiquet has hit it off with her French colleagues. She's been careful to listen and learn. During her Paris stint, she says, "I spent nine months with a piece of tape on my mouth." Lyle Saunders, vice-president of U.S. creative, recalls meeting a few months ago in Paris with his French counterpart who was surprised to learn Chiquet was American. He knew she lived in the States, "but assumed she was French born and raised." Chiquet's father would be proud. ■

Junk Keeps Defying Gravity

If history is any guide, low-rated bonds and loans should be tanking. Here's why they're not

BY JANE SASSEEN

FOR DECADES THE JUNK-bond market has followed a pattern that's about as regular as spring following winter. Two to four years after a new wave of bonds hits the market, defaults on those

bonds surge.

This time, the pattern isn't holding. Given the huge runup in junk debt that began in 2003, many investors figured defaults would spike last year and began raising hundreds of millions for new distressed-debt funds to take advantage of the wreckage.

But a funny thing happened on the way to the meltdown: According to Moody's Investors Service, junk-bond defaults actually fell in 2006 for the fifth straight year, to 1.7%—well below the long-term average of 5%. The story is the same in the booming leveraged-loan market, which, thanks to more flexible borrowing terms, has become a favorite of the private equity firms raising billions for leveraged buyouts and the hedge funds that buy most of that debt. By the end of 2006, leveraged-loan defaults slid below 1%, an all-time low.

While many investors expect defaults to tick up this year, they've given up trying to call the turn. "They've simply been wrong too long," says Steven Miller, the managing director of Standard & Poor's LCD unit, which tracks the leveraged-loan market and is, like *BusinessWeek*, a unit of The McGraw-Hill Companies.

Some private equity players see a major

structural shift at play: Greater liquidity across the capital markets and the explosion of sophisticated financial instruments, they say, are reducing the level of risk permanently. But others say the cycle is just being delayed, possibly leading to a harsher crash when it turns. "The big question is whether the excess money

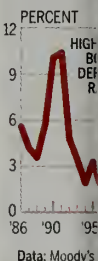
is simply giving weak companies rope they need to hang themselves," says David T. Hamilton, Moody's head of default research.

To see why some are worried, consider the record amounts of risky debt that flooded the market in recent years with junk bonds: New issuance has risen from \$62 billion in 2002 to an average \$127 billion annually over the last three years. And that market has been driven by the rise of leveraged loans, the high-yielding bank loans that hedge funds and other investors are snapping up. Since 2002, the issuance of leveraged loans has more than tripled, to \$480 billion last year, according to LCD.

It's not just the quantity of loans that's worrisome—it's also the quality. Much of the debt is rated B or Caa and below, the bottom rungs of the credit ratings ladder. Since 2004, roughly one-third of all leveraged loans issued each year have been rated B or lower, compared with less than 11% on average the previous four years. For junk bonds, the picture is even grimmer: In 2006 alone, some \$100 billion in low-rated debt hit the market, a surge William H. Calkins, managing director at Standard & Poor's, calls "unprecedented."

Those are just the bonds that tend to go belly-up. Between 1970 and 2005, one-third of all B-rated bonds defaulted within 10 years, according to Moody's; for Caa and below, the figure is even higher. Many defaults come sooner than that. In pioneering research done in the 1980s, Edward I. Altman, a professor at New York University, showed that bond defaults are concentrated early on, with the first three to four years of issuance. Credit market analysts refer to this phenomenon as "seasoning," the time it typically takes a risky company with new financing to either make a go of it or to go bankrupt. Since 1970, 36% of bonds rated B or less have defaulted within just three years, as have 17% of B-rated bonds.

NOWHERE TO GO BUT



for now, that isn't happening, and surge in LBO-fueled debt is likely to continue in 2007 as well. Interest rates remain astonishingly low. In 2003, rated debt typically sold for 5 to 8 percentage points above the yield of the Treasury bond; that spread has dropped to 3.4 points. "More and more people are buying very speculative debt pricing that just doesn't justify it," says Chew.

DEBT POOLS

OF WHICH LEADS to an obvious question: Why haven't defaults begun to pick up? Analysts cite a host of reasons, starting with the relatively strong economy and the recent muscle in profits. The biggest factors are the enormous amount of money sloshing around and the changing structure of the debt market. Foreign investors are shipping cash into the U.S. At the same time, there has been an explosion of new funds, distressed debt traders, and investors eager to buy junk-rated debt at higher yields it offers, much of it picked up and resold in other so-called financial instruments such as collateralized loan obligations. Together, these factors have combined to create a flood of pools of liquidity. Not only has it helped keep a lid on interest rates, holding debt payments down—it has also made funding readily available for struggling companies.

There's another reason, too: easy borrowing terms. Restrictions and stipulations on the financial health of the borrower are practically nonexistent these days, both for exotic leveraged loans and for corporate bonds. Historically, borrowers have violated such basic terms, they've been forced into default. Says Martin S. Fridson, a high-yield market strategist who runs the New York-based firm FridsonVision, the conditions "have been so watered down, there's nothing left to trip."

Fridson, like Altman, believes the pain is being put off and defaults will follow historic patterns. Both predict a slump this year and a sharper rise in 2008. And they say the level and severity of defaults may be worse when they come, precisely because weak players are continuing to pile on new debt. Altman believes defaults could eventually reach the 10% rates seen in the early 1990s in the wake of the last LBO boom. "Companies can keep getting money, and that's why," says Fridson. "But a lot of it is going to keep companies alive that really shouldn't be." ■

The Smart Money Says Sell

Stock sales by finance insiders may foretell tighter credit

BY MARA DER HOVANESIAN

EXECUTIVES IN FINANCIAL services are selling off shares aggressively—and that could bode ill for the broader credit market.

Insider selling isn't an inherently bearish signal. Plenty of executives sell company shares in regular patterns or for financial planning purposes—to pay college bills, say.

But the widespread selling now taking place in the financial industry is noteworthy, says Michael P. Painchaud, managing director at Market Profile Theorems Inc., a Seattle quantitative research shop. He recently crunched the numbers on 1,120 such companies, from investment banks to specialty-finance outfits. What emerged was a clear pattern of bearishness in the corner suite, especially at firms sensitive to consumer credit. "There is an inordinate amount of risk within the finance industry relative to last summer," he says. "The big picture is one of erosion [of confidence] relative to other industries."

Painchaud found that in the financial industry, the ratio of open-market sales to purchases by insiders is 5.18, vs. the historical average of 2.1. His model, which compares insider selling in June, 2006, with January, 2007, takes into account, among other things, the number of individuals selling or buying in the past 60 days and heavy options-related sales. What follows are companies for which a "deterioration in the outlook is most clear." *BusinessWeek* translated Painchaud's numerical scale into categories: "most bearish," "highly bearish," and "bearish." ■

Insider Selling

	COMPANY	TYPE OF BUSINESS
Most Bearish*	GOLDMAN SACHS	Investment bank
	COUNTRYWIDE FINANCIAL	Thrift and mortgages
	CHARLES SCHWAB	Brokerage
	ADVANCE AMERICA	Payday lending
	CAPITALSOURCE	Small-business lending
	ELECTRO RENT	Equipment leasing
	ADVANTA	Small-business lending
	ASTA FUNDING	Consumer receivable portfolios
	MCG CAPITAL	Midmarket LBOs and investments
	MARLIN BUSINESS SERVICES	Equipment financing
	FEDERAL AGRICULTURE MORTGAGE	Rural and agricultural mortgages
	PNC FINANCIAL SERVICES	Diversified lending
	COMMERCE BANCSHARES	Regional bank
Highly Bearish*	BB&T	Regional bank
	RENT-A-CENTER	Consumer durable goods rentals
	COMPUCREDIT	Consumer lending
Bearish*	ISTAR FINANCIAL	Corporate real estate loans
	CAPITAL ONE FINANCIAL	Consumer lending

*Based on Market Profile Theorems' analysis of insider sales
Data: Market Profile Theorems Inc.

More Merger Mania Ahead for Pharma

The scramble for new drugs is keeping companies on the prowl

BY ARLENE WEINTRAUB

DURING A LUNCHEON at the recent JPMorgan Healthcare conference in San Francisco, more than 500 institutional investors were asked to predict the fate of Bristol-Myers Squibb Co. The New York-based drug giant is locked in patent litigation with a company that makes a generic version of Bristol's \$3-billion-a-year anti-clotting drug Plavix, a debacle that contributed to the firing of CEO Peter R. Dolan in September. Using electronic keypads at their tables, 60% of the attendees forecast that if Bristol prevails in the case, which goes to court on Jan. 22 in New York, another pharmaceutical maker will buy it within a year.

Merger mania is sweeping through the life sciences sector—a trend that shows no signs of slowing. In 2006 a record 1,009 biotech, pharmaceutical, and medical device companies were snatched up for a total of \$135.9 billion, according to M&A tracker Dealogic. That's up from 923 deals in 2005 and 740 in 2004. With echoes of *Auld Lang Syne* still lingering in the air, 13 acquisitions worth \$1.2 billion are already in the can for 2007. Abbott Laboratories, which bought Kos Pharmaceuticals Inc. in 2006 for \$3.7 billion, is among the companies loudly declaring a hunger for more deals (page 76).

One might expect Boston Scientific Corp.'s disastrous \$27 billion purchase of stentmaker Guidant Corp. in January, 2006, which led to a 40% drop in Boston Scientific's share price, to dampen the excitement. Not so. "Demand has not diminished," says JPMorgan pharma

analyst Chris Shibutani, who notes that many companies presenting at the conference were marketing themselves as attractive partners for anyone looking to make a deal. "It was stunning."

A confluence of events is driving the deals. First, the American Jobs Creation Act of 2004 freed up pharma companies to repatriate more than \$100 billion in foreign earnings at a low tax rate—funds they can use to make investments. At the same time, dozens of blockbuster drugs started coming off patent and going generic, while some companies suffered disappointing clinical trials of drugs in their late-stage pipelines. Now companies are scrambling to find innovation beyond their own laboratories.

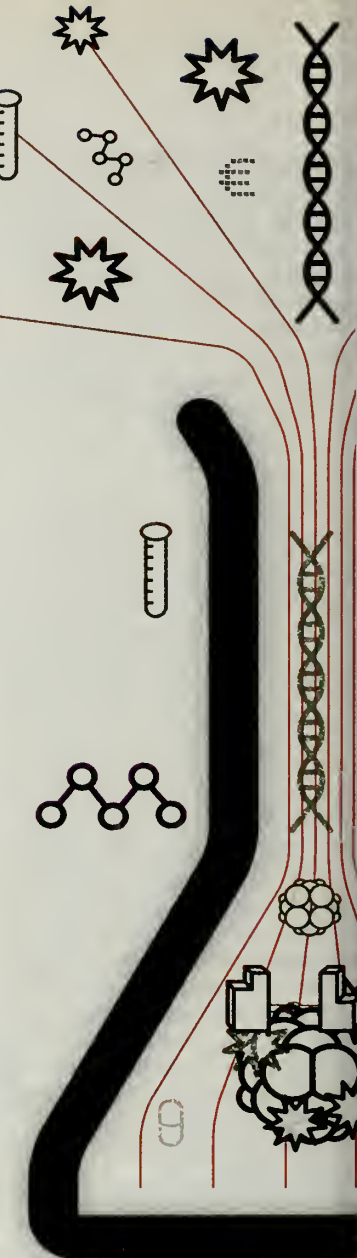
Among the major shoppers is Pfizer

Inc. Its \$12-billion-a-year cholesterol drug Lipitor will lose patent protection in 2011, and in December the company had to drop its experimental cholesterol treatment, torcetrapib, because of unexpected deaths in its clinical trials. On Jan. 22, CEO Jeffrey B. Kindler is expected to outline plans to slash billions of dollars in costs, which may include cutbacks in its \$7-billion-a-year re-

search budget. The company already announced a restructuring to improve the way it scouts for drugs developed elsewhere, and it has about \$8 billion in free cash to throw at the effort.

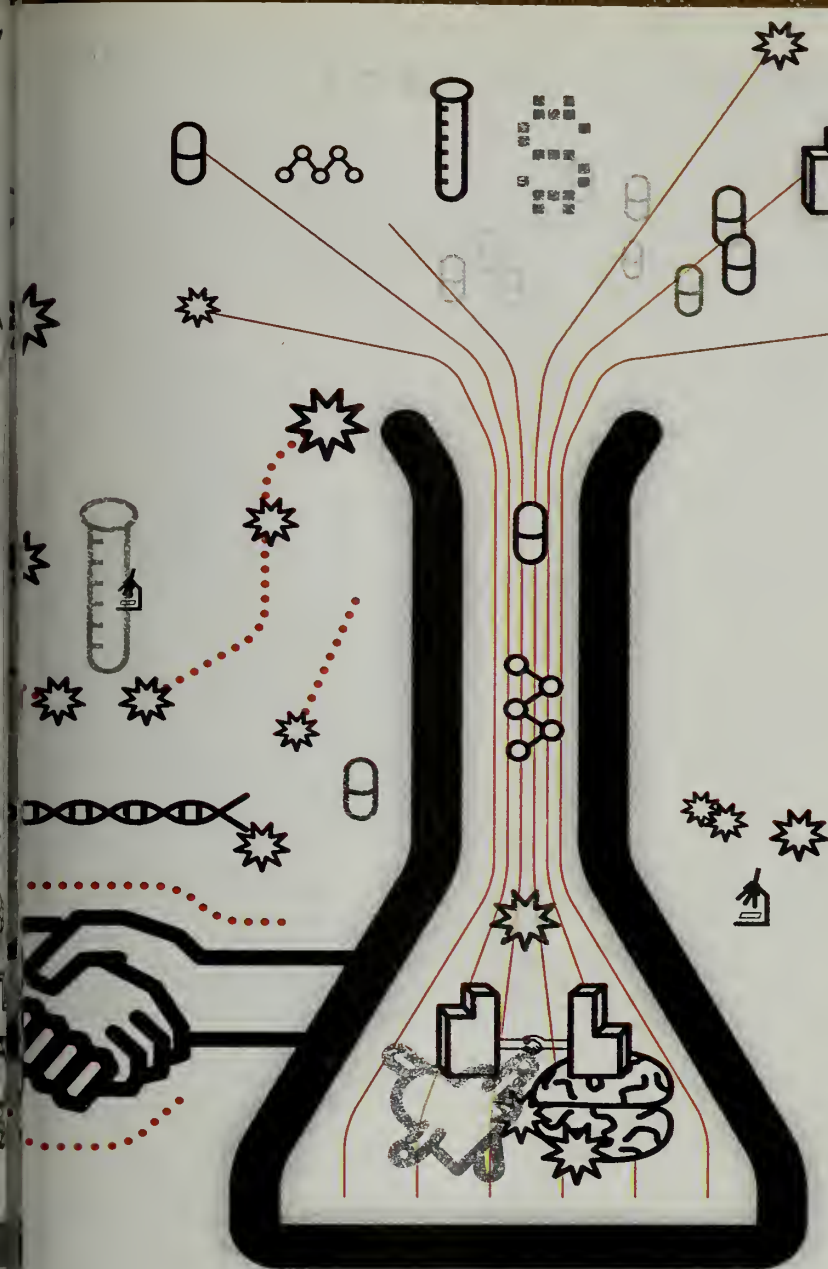
Venture capitalists say others are sniffing around their portfolios, too. Often a potential acquirer will follow a drug's progress through years of testing, letting VCs foot the bill, and then swoop in once they're sure the drug is well on its way to market. "Acquirers are willing to pay more for later-stage, de-risked assets,"

Some companies have been marketing themselves as potential partners



says Ellen Koskinas, a partner with West Partners in Menlo Park, Calif. year, Gilead Sciences, criticized analysts for not investing enough in gave its pipeline a major infusion paying \$2.5 billion for InterWest-Myogen, a biotech that's developing promising hypertension drugs.

Johnson & Johnson, which forked \$16.6 billion for Pfizer's over-the-counter drug unit last year, could continue its acquisition binge in 2007. With more than \$9 billion in free cash flow, J&J can make additions to its pharmaceutical and medical device divisions. The company recently picked up small stent device maker Conor Medsystems Inc. for \$1.4 billion and has expressed interest in buying a franchise in neuromodulation, a use of electrical signals to relieve pain, depression, and other disorders. Last year, analysts were buzzing that J&J



now showing promise in early trials, many analysts are betting it will be among the biotechs that get picked off. "Companies are looking for differentiated technologies," says JPMorgan biotech analyst Geoffrey Meacham. "Medarex has one of the better platforms."

As for Bristol, the Plavix trial and a Justice Dept. investigation into whether the company violated any laws in its dealings with generic drug-maker Apotex Inc. have overshadowed what is otherwise a promising outlook. Bristol launched four drugs last year, and six more are in late-stage trials. And on Jan. 11 it announced a collaboration with London-based AstraZeneca PLC to develop two diabetes drugs. The deal includes an up-front payment to Bristol of \$100 million, plus the promise of as much as \$1.25 billion in payments based on regulatory and marketing milestones. Could this be the courtship leading to marriage? Merrill Lynch & Co. analyst David Risinger raised that question in a recent report, noting that if Bristol doesn't name a new chief executive soon, speculation about a buyout will only grow. A spokesman declined to comment on M&A speculation except to say: "Everything we do is in the best interest of shareholders."

FULL PIPELINE

IN THE REALM of midsize companies, Wyeth could also emerge as an acquisition target. Last year, the Madison (N.J.) company settled the majority of the legal claims stemming from its pulled diet drug, fen-phen. Wyeth is still weighed down by concerns that its hormone-based menopause treatments increase the risk of breast cancer. Sales of the drugs have been declining for years and could take a further hit from a December report that suggested rates of breast cancer fell in line with a 2002 drop in the use of hormones. Wyeth's stock is trading at a price-earnings ratio of 16.5—a 16% discount to that of the Amex Pharmaceutical Index. But Wyeth has about 60 drugs in development, and it could file for a half-dozen or so approvals this year. "This is the best pipeline we've ever had at Wyeth," Dr. Joseph S. Camardo, senior vice-president for global medical affairs, told a group of investors at the health-care conference. Camardo had to be shooed off the stage because he couldn't describe all of Wyeth's upcoming drugs in his allotted 30 minutes. That's a problem a lot of Big Pharma companies probably wish they had. ■

Medtronic Inc. for its stents, defibrillators, and neuromodulation products. But Medtronic's stock has risen over the last year, and with a market cap of \$62.5 billion it would be a lot to buy, even for J&J. Instead, J&J and other device companies are likely to cherry-pick among more bite-size startups. Technology "platforms" that have yielded marketable products can nonetheless be sought-after acquisition targets. In October, Merck & Co. paid \$1.1 billion for San Francisco-based Sirna Therapeutics, which is developing drugs based on RNA interference, a method for turning off the expression of genes. The company's lead product, to treat the eye disease macular degeneration, is years away from being proven out, but Merck executives believe the technology could lead to drugs to treat many other diseases ranging from asthma to cancer.

Another platform company that may be on the radar screen of potential acquirers is Medarex Inc., which has developed a mouse with a near-human immune system. It could simplify the process of identifying compounds likely to work in humans. In December, 2005, Amgen Inc. acquired Medarex rival Abgenix Inc. for \$2.2 billion. With Medarex' cancer drugs

Deal Fever

Biotech, med-tech, and pharma mergers are outpacing overall M&A activity

YEAR	NO. OF DEALS	GROWTH	M&A GROWTH, ALL SECTORS
2004	740	25%	13%
2005	923	25	18
2006	1009	9	6

Data: Dealogic

ABBOTT LABS

Diagnosis: Shrewd Moves

BY MICHAEL ARNDT

Over the last nine months, Abbott Laboratories has dished out \$10.1 billion for acquisitions, including \$3.7 billion for cholesterol drug specialists Kos Pharmaceuticals Inc. This year, many analysts figured, Chairman and Chief Executive Miles D. White would take a breather to allow the company to absorb its newest assets or lighten its \$7 billion debt load. The analysts figured wrong.

Just a month after closing the deal for Kos, Abbott was set to announce on Jan. 18 that it was selling about two-thirds of its \$4 billion diagnostics business to General Electric Co. for \$8.1 billion in cash. While emphasizing that he's not going to rush into doing deals, White says he'll likely use the money to buy more medical products outfits to help boost overall sales and profits by at least 10% a year into the next decade. When it comes to acquisitions, White says, "you can never afford to rest."

White, 51, has been wheeling and dealing almost since the day in 1999 that he was promoted to CEO, after earlier heading Abbott's diagnostics operations. He began with a bang, paying \$7.2 billion in cash for the Knoll Pharmaceuticals Co. subsidiary of Germany's BASF in 2001. Among other deals, White bought TheraSense Inc., an Alameda (Calif.) maker of devices that monitor blood glucose, for \$1.2 billion in cash in 2004.

While many big drug companies have come to rue their growth-by-acquisition strategies, analysts say Abbott has done well. The Knoll purchase, for example, yielded Humira, a drug for rheumatoid arthritis that topped \$2 billion in sales in 2006. And a \$4.1 billion takeover of Guidant

Corp.'s stent operations in early 2006 gave Abbott a drug-coated stent, branded Xience. If it passes final clinical trials, it could hit the U.S. market by year-end; it's projected to reach \$1.5 billion in sales in 2008. "They've generally been pretty shrewd purchasers," says Phillip Nalbene of RBC Capital Markets in San Francisco. Abbott hasn't overpaid, he notes, and has been adroit in integrating personnel and facilities, often putting managers of acquired entities in charge of similar Abbott units.

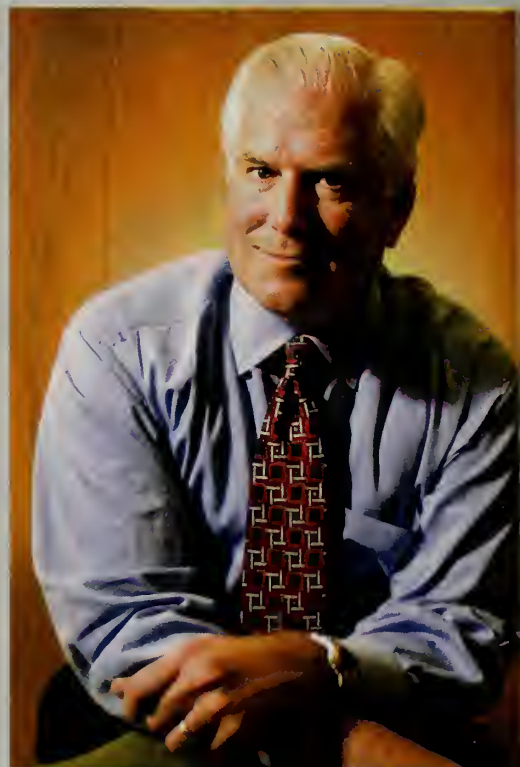
White's dealmaking has lifted Abbott's top and bottom lines. In 2006, Abbott earned \$3.8 billion on sales of \$22.5 billion, with gross margins nearing 59%, says Glenn J. Novarro of Banc of America Securities in New York. That's up roughly 10% annually from \$2.4 billion in net income on \$13.2 billion in sales in 1999,

when gross margins were 54.5%, and puts Abbott ahead of Merck, Bristol-Myers Squibb, and Eli Lilly in sales and earnings growth.

Abbott hasn't been only a buyer. The North Chicago (Ill.)-based company spun off its \$2.6 billion hospital-supply division, now known as Hospira Inc., in mid-2004. Like Hospira, the diagnostics operations going to

GE were considered slow growers within Abbott, which lacks the breadth that GE's \$16.6 billion health-care segment has in producing big-ticket medical equipment for hospitals, clinics, and high-volume labs.

The business also had been troubled.



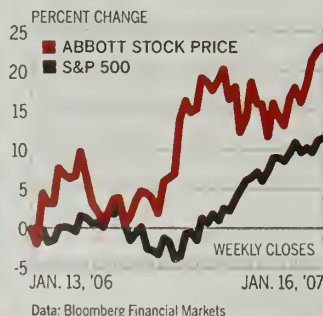
WHITE Looking for medical products companies

The Food & Drug Administration had barred Abbott from producing many of its diagnostics tests for four years after uncovering problems at its main plant throughout the 1990s. Abbott returned to the market in 2003 after paying more than \$225 million in fines and related costs. In the GE deal, Abbott is keeping its molecular and diabetes diagnostics businesses, while GE is picking up Abbott's clinical and consumer blood-testing kits, which had estimated sales of \$2.5 billion in 2006.

White's role model for Abbott is Johnson & Johnson, which has grown through takeovers and is praised by analysts for letting its divisions run themselves. It also counterbalances drug operations, which can be volatile, with stabler segments that sell medical devices and consumer products. Abbott similarly relies on pharmaceuticals for 55% of sales and medical and nutritional products for 45%.

Selling the diagnostics operations will shift that ratio to an out-of-whack 65%-35%. But not for long. Abbott has a 20-person business development team that works full-time with chiefs of Abbott units to find and evaluate deals. "We make sure we're up-to-date on our homework so that we want to get into a new segment," White says. "We won't be doing nothing."

OUTPERFORMING THE MARKET





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STREET THEATER Leeds and Campbell on the scene receiving a gift in New York's Times Square

show takes a humorous slant toward most of its subjects and runs parodies. A sketch featuring actor Khristian Lewis wildly spoofing CNBC talk show host Jimmy Kimmel garnered over 30,000 views, making it *Wallstrip's* most popular episode.

SPOOF IN THE CITY

INSTEAD OF FOCUSING on earnings ratios and the opinions of Wall Street analysts, most episodes of *Wallstrip* zero in on a stock that has recently hit a new weekly high. A recent episode filmed in New York's Times Square

instance, spotlights Aaron Rents, which leases appliances and electronics to a mainly low-income clientele. The stock has jumped 25% in the past six months to an all-time high.

Amid teeming New York crowds, crew preps for this episode, a spoof of the game show *The Price Is Right*. Campbell, who sports a beehive do and a style black overcoat, enlists passerby to guess the price of objects from Aaron Rents. To demonstrate why the company makes so much money, Campbell hands each bystander a flash card with a picture from Aaron Rents and the item's price at a regular store. Co-star Andrew Leitch, meantime, quizzes them: "So you want to buy this computer from Dell for \$2,999.99. How much would it cost to rent it from Aaron's?" Few come close to the real answer: \$1,319.87. *Wallstrip's* isn't trying to ridicule its contestants; it's criticizing Aaron Rents. They're trying to show viewers why the company has such high margins.

Street theater is just one offbeat element that sets *Wallstrip* apart from traditional financial news shows. Instead of the typical hands-off approach of professional reporters, Lindzon, who picks every company featured on the show, doesn't hesitate to recommend stocks he has stakes in. When that happens, Campbell simply discloses the conflict.

The crew heads downtown to film an episode, only to discover that *Wallstrip* is being featured at the top of Yahoo! video site. Although coveted, even a mere appearance only underscores the success of the new digital world. The Yahoo! *Wallstrip* sits between a video of a chimp that does karate and comedy twins arguing over a hat. ■

Stock Tips for Generation YouTube

A sassy new investment Web show, *Wallstrip*, is quickly luring viewers—and financial backing

BY AARON PRESSMAN

FOR YEARS, THE ONLY WAY investors could get their stock advice rolled up in a fast-paced, entertaining video show was by tuning in to the likes of CNBC and Bloomberg. There was nothing on the Net resembling the quick, catchy tech news shows and comedy series fans flock to online. But now, video producers and wannabe stars are pooling their talents and cheap digital cameras to create *Wallstrip*, a daily show examining top-performing stocks.

The timing seems perfect, with pioneering online video series such as *Rocketboom* and *Ask a Ninja* drawing hundreds of thousands of viewers and Google Inc. snapping up YouTube for \$1.65 billion. Many people are now betting that 2007 will be the year money starts flowing to top indie video creators. In many ways, *Wallstrip* fits

the formula for a popular digital series. The three-minute show features Lindsay Campbell, a fetching 29-year-old actor, as host. And its audience is growing fast, hitting 10,000 daily viewers within three months.

But what really sets *Wallstrip* apart is its ambition in the business news arena. *Wallstrip* creator Howard Lindzon, a small-time hedge fund manager with an eye for Internet startups, is betting that a short, savvy, tongue-in-cheek approach will create a highly profitable niche among twenty- and thirtysomethings turned off by old-school business news.

To further entice this hard-to-reach demographic, Lindzon enlisted a group of 10 financial and venture-capital bloggers to contribute regularly to the site. And he raised more than \$500,000 in angel funding to create a slate of shows.

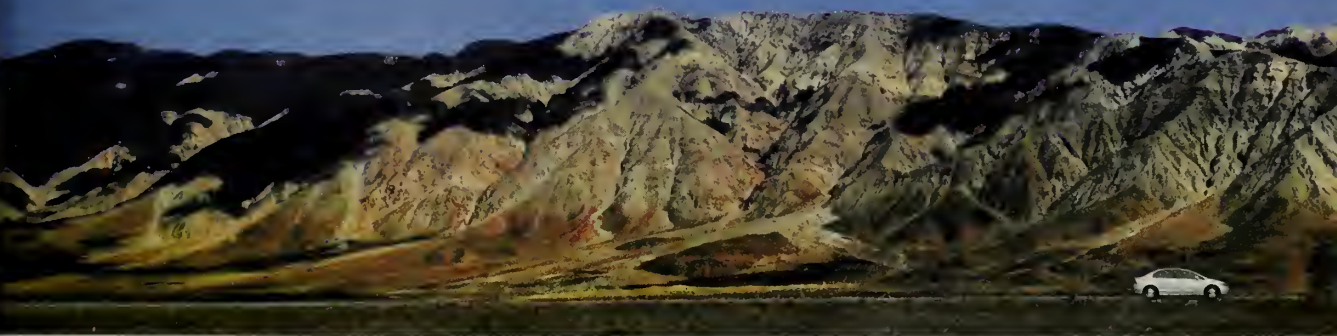
Lindzon and his merry band are a radical departure from run-of-the-mill financial market coverage. The

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HONDA
The Power of Dreams

Mentoring Can Be Messy

Companies love it, but what if that colleague just wants your job?

BY SUSAN BERFIELD

WITH NEW YEAR'S resolve still fresh, this is the time when many people start thinking about mentoring. Across the country, senior managers hoping to identify and influence young talent are being matched up with eager junior staffers keen for the opportunity to discuss...themselves.

Companies are hot on the practice these days, believing it encourages loyalty, diversity, and cohesion. Fully half of the 500 biggest businesses in the U.S. now offer mentoring, up from about 10% five years ago, according to Menttium Corp., which sets up such programs for corporations.

Mentoring is supposed to be one of those rare activities that benefits everyone involved. But these relationships can be as intense, messy, and disappointing as any other. They can go awry in any number of ways, small and large, leaving behind disenchantment, unease, and, at worst, bitterness. "Like anything, if mentoring goes wrong it can do harm," says Faye J. Crosby, a pro-

fessor of psychology at University of California at Santa Cruz who has done extensive research on the practice. She compares it to investing: Done well, it can make you rich; done poorly, you can lose a lot.

One of the most common problems, especially with formal programs, is simply that the mentor and apprentice are incompatible. As we all know, there's no accounting for chemistry. Even the best intentions and most thorough questionnaires can't always identify what might really irritate you about the other person. Different body clocks, speaking styles, or schedules can quickly frustrate a relationship.

Sometimes the mismatch goes deeper,

Ambition, jealousy, or a simple lack of chemistry can sour a relationship

though. One young woman didn't want to be identified with a company within a year of joining in part because she thought her mentor wasn't doing as well as some of their less significant clients. "Those weren't the ones I wanted to cultivate," she says.

Respect isn't enough, though. Ideally, both people know they want out of the arrangement.

"I haven't seen a real positive relationship that didn't have specific goals," says Kim Wise, the head of Mentor Resources. These might include learning how to manage a big project or several employees or a budget, developing an expertise that makes a transfer more likely. And once that happens, it's usually time to move on, maybe to another mentor. The success of these relationships is more than a year.

That doesn't mean the apprentice can't go back for advice or keep in touch. "Don't obliterate the relationship. Change the intensity," says Wellington, author of *Be Your Own Mentor*, who has outgrown a few mentors herself. Her other piece of advice: end gracefully, but unequivocally.

Things can get ugly when a mentor won't accept that an apprentice needs them. This is particularly common when men get too comfortable in the role as career coaches, especially when w-



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BE DISCIPLINED

Don't leave anything to chance. "We recommend that people set specific goals and decide how they'll know when they've met those goals," says Kim Wise, head of Mentor Resources. Most experts say that after a year, you should both move on.

KEEP IN TOUCH

Even after the relationship reaches its natural conclusion, staying in contact with your mentor isn't a bad idea. "You want someone to tell you when you're walking off a cliff," says Sheila Wellington, author of *Be Your Own Mentor*.

END IT GRACEFULLY

If a mentoring relationship isn't working, don't prolong the problem. If you're in a formal program, talk to those in charge. If the relationship is informal, give your mentor permission to get out. In other words, make it look like ending it is her decision.

women. It's the Daddy-knows-best
ome. Mary Cheddie, a 50-year-old
n resources executive, recommended
er mentor—a man she had come to
ler a friend—for a senior position at
company. She wishes she hadn't. For
st time, they were working as peers,
e decisions she made directly affect-
work. "I wasn't a threat," she says.
e had a hard time recognizing that I
the junior executive anymore."
ty soon the relationship deteriorated.
e no longer the person I knew," she
him yelling down a hallway at their
"No, I've grown," she said. "I didn't
ou to," he shouted back. Those were
st words they spoke to each other.
oth eventually left the company.

RIOR MOTIVE

WORS CAN RUN into serious prob-
is well, none more so than the ul-
motive. Sometimes the apprentice
wants their job. That's what hap-
recently to a female executive who
en mentoring women for 30 years.
escribes the experience as being
vn under the bus."

had been working with a young
n for several months when her
began asking pointed questions
her own performance. She couldn't
out why until colleagues told her
er student was whispering in the
ear. "I didn't want to believe it,"
e executive. "No one had been that
itous or self-serving before." Now
unts the young woman fired.

he displays of ambition aren't quite
w, but still do damage. Like when
ung charge thinks he knows more
he mentor. Richard Laermer, the
ur-old chief executive of RLM PR
o-author of the forthcoming book
Marketing, was developing a tal-
protégé who seemingly could do
ong. Then, one day, the young guy
d that a client's business model
sufficiently impressive to warrant
on. Laermer says he didn't real-
at was happening until the client
is firm. He was chagrined by the
nt. "Who taught him that?" he
red. Laermer never raised the mat-
h his protégé, and weeks later the
ft the company of his own accord.
ermer didn't attend his going-away
"A lot of people thought that was
ile," Laermer says. "But I was too
Later, the erstwhile client was
gt for a huge sum of money, a vin-
n of sorts for Laermer. He says:
much harder boss because of that
eence." ■

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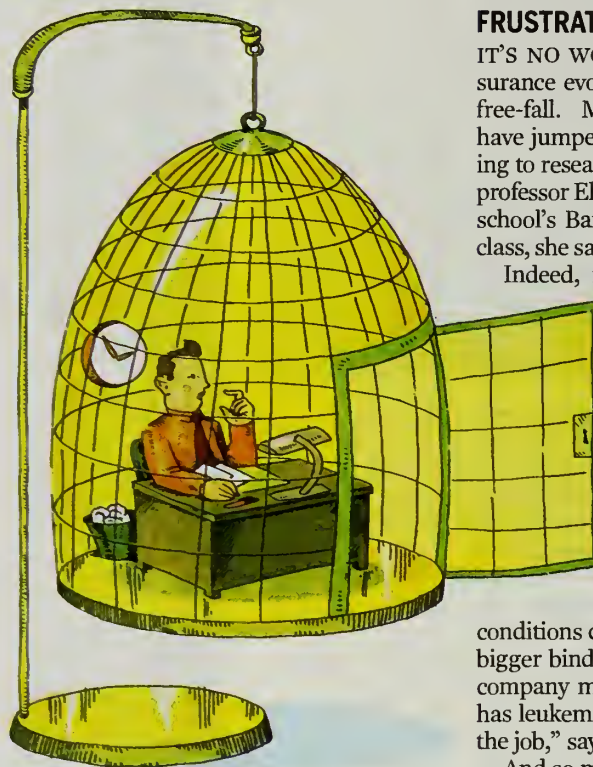
BY MICHELLE CONLIN

WITH THE DEMOCRATS ascendant, the political climate is ripe for another push for universal medical coverage. Kelly Services Inc. Chief Executive Carl T. Camden, a proponent of fixing health care once and for all, is taking advantage of the opportunity by rolling out new rhetorical ammunition. Workers, he says, are increasingly shackled to their jobs for no reason other than to cling to their employers' health insurance coverage. These are people, he says, "who don't leave a job even though they're unhappy and would be more productive somewhere else."

Economists and academics call this phenomenon "job lock." Studies say it could reduce job mobility by up to 25%, according to Brigitte Madrian, a public policy and corporate management professor at Harvard University's John F. Kennedy School of Government. A fluid labor market is viewed as a prime driver of U.S. economic growth relative to other industrialized countries.

Job lock creates friction by artificially tethering people to their jobs. Camden is one of a growing group of CEOs—from the heads of the big auto companies to Starbucks Corp.'s Howard Schultz to the Business Roundtable—who are pressing Washington to take action on this vexing issue. The only way to solve the stickiness in the labor market, Camden says, is to sever the link between jobs and health care.

"Job lock" is being used to argue for universal coverage



It seems there's a health care refugee in every office. For many years, Kathryn Holmes Johnson sat at her desk fantasizing about getting a new job doing what she really loved: public relations. But the marketing executive at a local government agency in Virginia had a husband and two little girls who all had asthma and other health issues. They depended on her medical coverage. The \$2,000 a year in co-payments for the family's prescription drugs alone would have turned into \$85,000 without insurance. Looking for a job or switching jobs, Holmes Johnson feared, could jeopardize the family's coverage. So she stayed. And stayed. And stayed, a hostage to her health care.

The 1986 Consolidated Omnibus Budget Reconciliation Act (COBRA) was supposed to remedy this. It states that all large employers must make unsubsi-

dized health coverage available to employees for the first 18 months after they leave a company. But COBRA policies are expensive. For a family of four, a policy can start at \$700 a month. Only about 7% of people who lose jobs say they can afford COBRA, according to Camden. And health insurers and employers are getting stricter about taking people with preexisting medical conditions onto their policies. "No one wants to worry when they leave one job to find out the next that their Social Security is interrupted," Camden says.

FRUSTRATED ENTREPRENEUR

IT'S NO WONDER the loss of health insurance evokes the specter of a financial free-fall. Medical-related bankruptcies have jumped 2,200% since 1981, according to research from Harvard Law School professor Elizabeth Warren, director of the school's Bankruptcy Project. The new class, she says, accounts for 90% of all

Indeed, in surveys, the No. 1 reason that would-be free agents balk is the fear of losing their health care. In all, one-third of jobs in the U.S. provide no health insurance at all, and the number is growing. Many Americans, especially low-wage retail workers, simply can't afford an employer's plan. Those with preexisting medical conditions can find themselves in an even bigger bind. "A new employer at a company might find out your 6-year-old has leukemia and decide not to offer the job," says Madrian.

And so many workers will keep hanging on to jobs they hate. One mom in New York, for example, is staying with her graphic design job to retain the health coverage for herself and her son. Half her pay goes to her share of the monthly premiums. Wish? To start a business doing baby products. "I feel stuck," she says.

After a decade of working in a job she wanted to leave, Holmes Johnson found the courage to move on. "Starting my own thing was too overwhelming. My husband's plan did not offer the coverage to make us feel secure," she says. A few months ago, she landed a public relations position with a company paying a salary at Washington law firm S. Kessler Goldstein Fox. After checking the firm's formula for prescription coverage, she made the jump. In other countries, she wonders, would health be the deciding factor? ■

EXPERT INSIGHTS

Reports on Sales Effectiveness & Customer Relationship Management



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es Crisis: The Velocity of rmation and the Quality Revolution

the website homepages of five top company industry. Imagine those homepages company names and logos. Can you distinguish differences among them? And alike, don't they?

In the past fifteen years, two forces have come to dominate most products and services in the marketplace: the velocity of information and the quality revolution. Because these forces are growing exponentially more powerful, no service is safe.

Not long ago, customers had to see salespeople to learn about products and services because information was not easily obtainable elsewhere. The salesperson, therefore, required talking about the

features of their offerings. Such is no longer the case. Today customers can access reams of information instantly on the web. This has had two effects:

1. Customers have an increasingly difficult time identifying valuable differences between competing offerings.

2. Competitors can copy innovations and produce competing versions with ever-increasing speed.

The quality revolution has likewise reduced differences that customers once found valuable. Today, products and services are far more reliable. As quality has increased since the onset of methodologies like Six Sigma, obvious differentiators are

much more difficult to produce and sustain. In the past, variability in quality across the spectrum of products in any given industry was quite dramatic. Now, competing products simply don't have much quality difference.

As a result of the velocity of information and the quality revolution customers no longer receive value from salespeople who simply talk about their offerings and describe how they can help solve current problems. The internet is faster, cheaper and easier than meeting with sellers. Additionally, decision-makers are no longer even paid to solve today's problems. Instead, they are expected to look over the horizon and anticipate new challenges and opportunities. To compete successfully—and, in many cases, keep their jobs—today's sellers must learn to apply their expertise and insight to help customers prepare for the future.

To read the full report, go to www.expert-insights.com/huthwaite.asp

Huthwaite Huthwaite's business is sales performance improvement. Pioneers in the application of behavioral analysis to benchmark sales excellence in the field, they combine empirical research with the fundamentals of organizational change and world-class training to improve the effectiveness of sales professionals. In short, they help clients diagnose challenges, define success, prepare for change, implement sales performance solutions and support ongoing improvement. Ultimately, their goal is to help clients achieve specific business outcomes that are best addressed by improving sales function. www.huthwaite.com For more information, contact Steve Warner, VP, Marketing at (703) 467-3849 or at marketing@huthwaite.com.

Demand CRM - the Holy Grail for Mid-Market Companies?

was the Fortune 500 and now it is the mid-market company that seeks the ultimate business tool; a tool that will serve up sales, increased customer retention, forecasting and a clear path to profitability. Is CRM that Holy Grail and if so, is it proving so elusive to the mid-market company?

The management team that gets it right, the rewards for implementing a successful Sales Force Automation system are less than spectacular. Sales organizations that once meandered along can be transformed into focused selling machines generating 40% higher revenues.

With the rewards so high, it is astounding that so many mid-market CRM implementations fail. Many people lay the blame on missing features in their chosen CRM systems. However, the most common cause of CRM failure is a lack of adoption by salespeople who become frustrated with overly complicated products. Eventually, widespread frustration causes CRM systems to be abandoned.

Why is it so difficult for sales people to adopt CRM? Surprisingly, much of the blame lies in the business model of many CRM vendors. Their strategy is to sell software cheaply and then recoup costs on the back end by selling expensive professional services for

implementation, training, and customer service. Since profits come from these services, CRM vendors have an incentive to build overly complicated systems that require a lot of training and support. Often, the result is that customers skimp on these services and the cycle of failure occurs.

If these vendors changed their models to offer CRM at a competitive monthly price that included standard services for implementing and training their customers, their interests would match those of their customers. Vendors would then have every incentive to make their systems simple, stable, and trouble-free.

All in all, mid-market companies want CRM to be easy to use, effective, reasonably priced, and free of hidden costs; for them, this is the true Holy Grail.

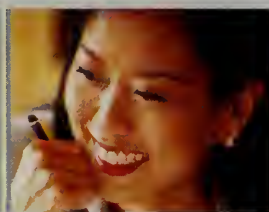
To read the full report, go to www.expert-insights.com/auric.asp

Auric Technology is an on-demand CRM vendor focused on small and mid-sized companies. Auric Technology's product, the Prospector, is tailored for salespeople on the go, as it supports interaction via the web, email, PDAs, and laptops disconnected from the Internet. Auric's unique service model has been popular amongst small and mid-sized businesses venturing into on-demand CRM for the first time. New York, NY (212) 573-0941 www.aurictechnology.com



EXPERT INSIGHTS

Reports on Payroll Outsourcing
& Marketing



To read full reports and related information, go to the links listed below or visit www.expert-insights.com

Businesses Find Payroll Outsourcing More Important Than Ever

The advantages of payroll outsourcing are more appealing than ever, judging by the number of businesses that now rely on an outside service. Paychex and ADP – the two largest national providers – are currently the choice of more than a million businesses, a total that has doubled in the last decade. The majority of their clients are companies with less than two dozen employees.

While outsourcing allows more time for concentrating on the moneymaking aspects of a business, freedom from compliance issues, safety, convenience, cost savings, and other factors are frequently mentioned by business owners as benefits.

However, payroll of a decade ago is not today's payroll. Larger providers have raised the bar with more product features, extensive support, performance insurance, and redundant processing (for example, following the Gulf Coast hurricanes, national providers helped clients stay in business by processing and delivering payrolls from unaffected areas). Selecting a national supplier with highly integrated payroll handling capabilities is of growing importance because payroll is increasingly linked to a number of other HR tasks.

- It is key to the management of workers' compensation and state unemployment insurance (SUI) costs.

- It is a vital step in collecting and accurate health and dental insurance.

- It is fundamental to the smooth administration of a company's retirement and section

This means as a business owner three basic choices. Select a desktop software solution with limited expansion capabilities, and arrange for a local vendor who will supply payroll like 401(k) and insurance piecemeal. Or, select a source company like Paychex and perhaps some limited third-party services you source others separately. Or, select a comprehensive solution far beyond just payroll. Your goal should be in line with other business decisions: define your needs and answers that will best meet those needs now and in the future.

To read the full report, go to www.expert-insights.com/paychex.asp

PAYCHEX

Paychex, Inc. (NASDAQ:PAYX) is a leading provider of payroll, human resource, and benefits outsourcing solutions for small and medium-sized businesses. The company offers comprehensive payroll services, including payroll processing, payroll tax administration and employee pay services. Human resource services include 401(k) plan recordkeeping, workers' compensation administration, section 125 plans, time and attendance solutions, and other administrative services for business. Paychex has more than 1 million and over 543,000 payroll clients nationwide. For more information about Paychex, visit www.paychex.com.

The Corporate Client as a Family Unit: Why Market Intelligence

Consumer marketing has long championed market segmentation as an effective way to, among other things, group prospects and aim effective messages toward them. But does the same approach work in the business-to-business space? Do businesses act like consumers? The answer: businesses act more like extended families. Individuals make final decisions, but children, parents, aunts and uncles influence choices. As with families, different individuals in the same company have different and evolving needs, especially in the technology and telecommunication arenas.

Thinking of a corporate client in this way requires a business development strategy anchored on first-rate profiling of existing customers and top

prospects. It is not enough to simply understand their industry, size, and what they bought last year. Marketers need to understand how each client's and prospect's infrastructure is deployed, initiatives these customers are undertaking, and who makes key decisions. Today, a corporate client's needs change fast, and a database must constantly track those critical changes if a client relationship is to be optimized.

Most essential is constructing and maintaining an ongoing flow of consistent, reliable "prospect intelligence." Most businesses have a customer data warehouse, but research shows that in b-to-b marketing, it often is incomplete -- a problem only exacerbated when prospect data are involved. To

overcome these obstacles, business marketers must acquire (and maintain) data that goes beyond their own customer data by prospect data from multiple media and by employing third-party market research sources that focus squarely on the b-to-b market.

Prospect intelligence, combined with analytics, will produce unique profiles of customers. Marketers then can target with files, finding new best-customer "lookalikes." Most business marketers, with finite resources, choosing who not to pursue is often the challenge. Target well using this methodology, and a marketer is half the way home. No other area of business development distinguishes winners from losers than the collection and use of good prospect intelligence.

To read the full report, go to www.expert-insights.com/harte.asp



Richard M. Hochhauser is president and chief executive officer for Harte-Hanks, Inc. Harte-Hanks, Inc. (NYSE:HHS), San Antonio, is a worldwide, direct and targeted marketing company that provides direct marketing services and shopper advertising opportunities to a wide range of local, regional, national and international consumer and business-to-business marketers. Visit the Harte-Hanks Market Intelligence Web site at <http://www.harte-hanksmi.com> or call (800) 854-8409.



r from Hallmark's est Moment

Hall clan wants to sell its money-losing channel, but buyers aren't exactly lining up

NALD GROVER

HALLMARK CARDS IS HAVING a moment that's anything but warm and fuzzy. A decade after plunging into the cable TV business, Hallmark is trying to dump its Crown Media Group, which owns the money-losing Hallmark Channel, among other properties. The parent, based in Kansas City, Mo., hired a new CEO to sell Crown Media last year. Hallmark's foray into the entertainment business is an object lesson in how not to run a media company. Since going public in 2000, Crown Media has lost nearly \$1 billion, while its stock has fallen 22%. Last year the founding Hallmarks, which own 67% of the company, said it could get \$2 billion for the company. But analyst Alan Gould of in-

vestment bank Natexis Bleichroeder Inc. says it might fetch \$1.2 billion. Of that, the Halls would probably get about \$800 million, barely enough to cover the cash they have lent the company to cover its losses. Says Gould: "No one is out there crying: 'I want my Hallmark Channel.'" From the start, the Hallmark Channel was a hard sell. To get the cable and satellite guys to carry it, at first Crown Media had to pay big money and promote the channel in some of its 4,000 stores, says former Crown Media Chairman Robert A. Halmi. The tactic helped the channel grow from 27 million viewers in 2000 to 74.7 million today. Still, the distributors pay Crown Media only 3¢ per subscriber per month. Even the lower-rated History Channel gets 19¢ a head. Ironically, the Hallmark Channel is one of the most-watched offerings on cable—its ratings are in the top 10. But the

GOLDEN OLDIES The Hallmark Channel has plenty of viewers, but their median age is 60

median age of its audience is 60, hardly the demographic advertisers crave. The programming lineup, dotted with such golden oldies as *The Waltons*, *M*A*S*H*, and *Matlock*, generates an average daily ad rate of only \$2.48 for every thousand viewers. That's a fifth of what the likes of TNT get, says Brad Adgate, senior vice-president at ad buyer Horizon Media.

The Halls, who declined to comment for this story, are like many wealthy clans: They lack the killer instinct to prosper in Hollywood. The family lost a bundle building and selling a Spanish-language network that eventually became the Univision colossus. In 2000 the Halls's Crown Media acquired the money-losing family and religious channel Odyssey and renamed it the Hallmark Channel.

But the Halls recoiled at spending hefty sums, and they were leery of programming they thought would harm the brand. Even today, the channel puts a disclaimer before *When Harry Met Sally*, with its famous fake-orgasm-in-a-deli scene. The Halls rejected Halmi's idea for a kids' channel based on Hallmark's Crayola brand crayons and were slow in rolling out the still-tiny Hallmark Movie Channel. Meanwhile, says an insider, cable operators began complaining that the channel was no longer being promoted at Hallmark stores. "I'm not sure [the Halls] ever liked TV," says former Crown Media CEO David J. Evans, who resigned last year. "They were so conservative."

Now the Halls have hired Henry Schleiff as CEO and asked him to sell the company. Good choice: Schleiff is a strong programming guy who fixed up CourtTV and sold it to Time Warner Inc. last year. And he has incentive aplenty: \$1 million in compensation, plus a \$6 million "transaction bonus" if he can make the sale.

Schleiff wants cable and satellite companies to hike the 3¢ payments to 15¢, though operators are resisting. After all, he can point to a recent ratings rise. But that's partly due to Crown Media's heavy spending to secure such big movies as *March of the Penguins*. Schleiff has a long list of potential buyers, including News Corp., which offered a lowball bid last year. "There's value there," says Halmi, "as long as someone other than Hallmark is trying to unlock it." If a buyer emerges, he reckons, the first thing they'll do is dump the name—hardly the happy ending Hallmark programs are known for. ■

Pilgrimage To the Heart Of Yoga

Devotees from around the world head for Mysore, India, home of the vigorous form called Ashtanga

BY SAVITA IYER



T 5 P.M. ON A BREEZY Saturday, the Ashtanga Yoga Research Institute in the southern Indian city of Mysore is buzzing. Students from around the globe are thronging the steps of the three-story, light-gray concrete building. Clad in light-colored cotton pants and T-shirts, their backs ramrod straight, their eyes and skin aglow, they are queuing up to greet Sharath Ranga-

swamy, 35, a master of Ashtanga yoga, and his grandfather, Gururji K. Pattabhi Jois, the institute's founder. Some are there to inquire about their classes, which start at 5 a.m. the next day, and some are still hoping to enroll. While there are numerous yoga centers in Mysore, a two-hour trip by car or train from Bangalore, Ashtanga Yoga Research Institute is the most well-known and the one that attracts the greatest number of visitors from overseas. Ashtanga, which means "eight limbs" in Sanskrit, is an extremely active form of yoga. It combines "vinyasa," or flowing breath, with "asanas," or poses. The rigorous mix heats the body in an intense workout that some say is equal to a grueling session at the gym.

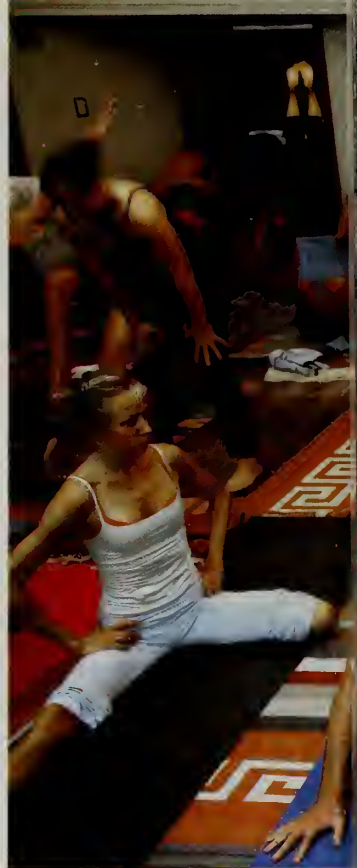
Russell Smith, a New York entertainment lawyer, says part of the attraction of Ashtanga yoga is the physical rigor. When he first took classes in New York, "I couldn't do any of the poses, and I felt awful," he recalls. "Even so, I was

on a cloud. The class really opened me up—the combination of movement and breathing was amazing. I'm hooked." Since 2004, Smith has spent at least three months a year studying in Mysore.

Perhaps because of the physical challenge, Ashtanga appeals to "type-A, over-achiever kind of people," says Andrea Varalli, a freelance graphic designer from Maui and student at the Institute. Yet even people who push themselves, he says, soon realize that, as in all yoga prac-

tices, "the physical part is just an into enhanced mental well-being."

Classes start at 5 a.m., but many students arrive earlier to find choice for their mats. Five days a week, students are "Mysore-style"—that is, students work at their own pace while Sharath, who goes only by his first name, moves around the room, correcting students' poses and demonstrating new ones. On Mondays and Sundays, classes are taught





CLASS IN PROGRESS (clockwise) Students go at their own pace through the practice's poses as teachers move about, offering adjustments and suggestions; Institute founder Jois; Mysore Palace; teacher Rangaswamy

travels abroad. His workshops in New York, London, Sydney, and elsewhere have been attended by a host of celebrities, including Gwyneth Paltrow, Madonna, Willem Dafoe, Sting and his wife, Trudie Styler, and Mike D., drummer for the Beastie Boys. Sonya Jones, wife of hedge-fund magnate Paul Tudor Jones and a close friend of Gururji and Sharath, has made a few low-profile visits to Mysore, too.

While yoga beckons many tourists, it's not the only reason to visit. Mysore and its 1.5 million residents are still somewhat sheltered from the wave of modernity that has swept through India over the past decade. An ancient city, Mysore gained sovereignty as a kingdom near the end of the 18th century. The main palace, built in the Indo-Saracenic style that incorporates Hindu, Muslim, Gothic, and Rajput styles, was commissioned in the late 19th century and completed in 1912. It remains one of the city's most popular tourist attractions.

Mysore is also close to some of South India's finest wildlife sanctuaries. Two national parks, Bandipur and Nagarhole, draw visitors for jeep safaris into the jungle and stays at eco-friendly resorts. The area also boasts renowned health-and-beauty spas, such as Indus Valley Ayurvedic Centre, and the regal Brindavan Gardens, which has served as the colorful backdrop of countless Bollywood movies.

Residents have adapted enterprisingly to the stream of yoga adherents. Locals rent rooms, apartments, and even houses to visiting students, and they will arrange for phone and Internet service.

For travelers who prefer something more upscale, there are several good hotels in the area, including Hotel Regaalis, Royal Orchid Metropole, and Lalitha Mahal Palace Hotel. Rates run from around \$100 to \$170 a night for a double room. Dinner at a high-end restaurant, such as the Tiger Trail at the Royal Orchid Metropole, costs about \$40 to \$60.

The best times to visit are winter, fall, and—if you don't mind the monsoons—summer. The Institute is closed in April and May because it's just too hot, even for those who seek to transcend the physical. ■

Students follow a vegetarian diet, avoid alcohol, and rise early enough to make the 5 a.m. class. Most stay at least a month

as a whole. Beginners get separate instruction for part of the day. Class ends at 10 a.m., after which many students head to nearby cafés. Whatever they must be vegetarian. Alcohol, too, is off-limits.

A strict regimen doesn't seem to be a problem for the students, according to Dr. Fontoura, a senior research scientist at Yahoo! Research in Sunnyvale, who is on his first pilgrimage to Mysore. "I practice at 5 a.m. in California, too. I'm used to it. Everyone is."

A month's tuition is 26,900 rupees (about \$600), with additional months at 17,900 rupees (about \$400) each. There's no weekly rate since the school requires a one-month commitment—no refunds if you leave early, either, and some students do. The Institute is open from January through March and June through December, except for a short break around year-end.

When the school is closed, Sharath



Lincoln Goes Lexus

The 2007 MKX shows the carmaker's styling moving closer to that of its Asian rivals. **BY DAVID KILEY**



STYLE SWITCH It's no accident that the MKX's silhouette is reminiscent of the Lexus RX350. Like the Lexus, it is built on a front-drive platform and offers all-wheel drive. Lincoln's styling is moving closer to Asian competitors than to its bolder, flashier crosstown rival Cadillac.

POWER PLAY The car's standard 265-horsepower V-6 engine is powerful, yet it runs on regular unleaded gas. The six-speed transmission tops the Lexus' five, but it would be nice if the MKX had a manual mode that allowed you to do your own gear shifting.

INSIDE JOB Lincoln made sure the cabin was quieter than even that of the Lexus, which has the rep for the quietest cabins in the business. Folding and pivoting second-row seats can recline 15 degrees. With the second row folded away, the MKX

has 69 cubic feet of space.

SHINE ON The optional adaptive lighting system allows headlights

2007 LINCOLN MKX Base price, \$34,120; price as tested, \$39,660

to bend with you in a curve, aiding perception and providing illumination with 36 feet more range than fixed-beam headlights.

THE SKY'S THE LIMIT The panoramic option—a sliding sunroof and a fixed glass roof over the rear seats—gives an ups feel. Careful attention to extra tinting helps the cabin from heating up even at high

LOOKS LINCOLN The MKX's interior recaptures the brand's understated, premium styling that it lost in the 1990s. Highlights include indirect "cool white" puddle lighting and honey-colored wood brushed nickel and metal trim.

BRAND NEWS Judge the cachet and acceptability for yourself. Lincoln is not Town Cars or hearses anymore. ■





BY ROBERT PARKER

The Other White Burgundy

MOST FAMOUS WHITE BURGUNDIES come from the Côte d'Or, but the best values in these wines hail from the Mâconnais, the region just to the south. Here, young winemakers have begun bottling their own wines instead of going to cooperatives. They are also breaking with tradition by fermenting and aging their wine in stainless steel rather than oak, thus giving the wine a fresher taste. ¶ The vintage of choice is 2005, but 2004 offers many pleasant surprises and well-stored 2002s are drinking beautifully. Prices range from \$15 to \$30 per bottle, with a few old vine offerings pushing into the \$40-to-\$50 zone. Look for wines from the following estates:

Domaine de la Bongran

One of the great producers of pure, oak-free Chardonnay, la Bongran's Jean Thevenet has been a mentor to many younger winemakers. His wines have uncommon complexity, even though most are aged and bottled in stainless steel tanks, not oak barrels. Imported by Martine's Wines (415-625-400).

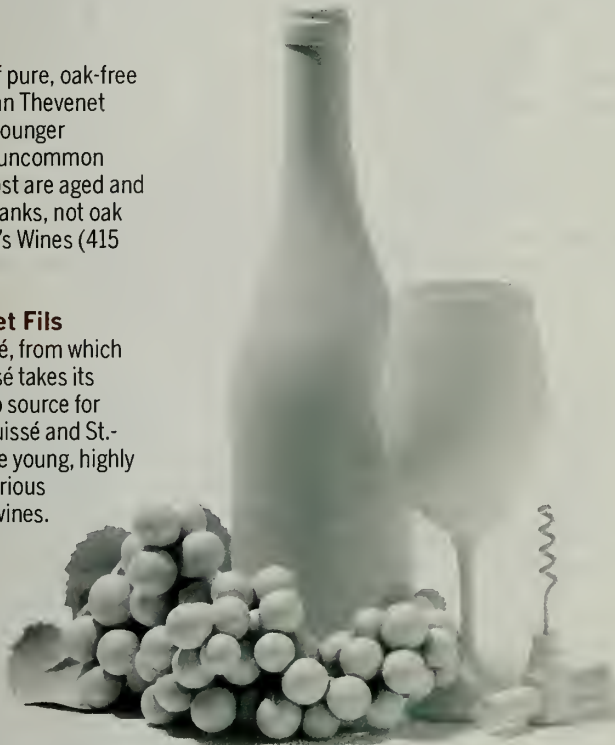
Domaine Cordier Père et Fils

Based in the village of Fuissé, from which the famous wine Pouilly-Fuissé takes its name, this vintner is a superb source for Chardonnay as well as Mâcon-Fuissé and St.-Véran. Christophe Cordier, the young, highly skilled winemaker, seeks serious complexity and intensity in his wines. U.S. American importers include Weygandt-Metzler (360-0800).

Domaine

Domaine Mot-Michel

Domaine produces a Chardonnay wine, a forward Mâcon-Villages Chardonnay, loads of honeyed lemongrass, white peaches, and a broad texture. It is a delicious wine to drink during its first few years of life. Imported by Kysela Père et Fils (540-9228).



Domaine Comtes Lafon

Famous for its red Burgundy, this domaine also makes a half-dozen or so offerings of 100% Chardonnay wines. They are crisp, delicious, and loaded with minerals, poached

pears, and buttered citrus. They offer lovely drinking during their first four to five years of life. Importers include Jeroboam Wines (212-625-2505).

Domaine Roger Lassarat

Lassarat produces wonderful wines under the St.-Véran and Pouilly-Fuissé monikers. The American importer has special cuvées marked "Cuvée Unique"; these are significantly better than the standard cuvée offerings sold elsewhere. Imported by North Berkeley Imports (800-266-6585).

Domaine Valette

Those looking for explosively rich, intense, full-bodied Chardonnays should check out the Mâcon-Villages and Pouilly-Fuissés made by the Valette family in the quaint village of Chaintré. These are full-throttle efforts made from ripe fruit that are almost New World-ish in their explosion of tropical fruit, honeysuckle, and intensity. In most vintages, they require consumption in their first three to five years of life. Imported by Kysela Père et Fils (540-722-9228).

Robert Parker is the world's most influential wine critic. Visit RobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

Have REITs Lost Their Footing?

With dividend yields now below those of T-bills, it could be time for smart investors to beat a retreat. **BY LEWIS BRAHAM**

IF YOU'VE PROFITED FROM the seven-year run in REITs, now might be the time to pull back. The total return on shares of publicly traded real estate investment trusts has been some 300% since the end of 1999, and many now look overpriced. In fact, the rally has wiped out a big part of REITs' appeal: attractive dividend yields. The average REIT now yields only 3.6%. That's less than half the 8% REITs paid in 2000 and 1.3 percentage points lower than the current yield on Treasury bills (chart). The last time REIT payouts dropped below Treasuries, in 1998, REITs fell 17%. And those comparisons were against higher-yielding 10-year Treasury notes. REIT yields have never been this low relative to T-bills. By law, REITs must pay out 90% of their taxable income in divi-

dends, and historically those payouts have accounted for much of their total returns. With such low current yields, today's investors can only hope that REITs will increase their payouts or that their underlying property values will continue to rise. Yet REITs, with average cash-flow growth of about 5% or 6% a year, usually don't grow fast enough to offer large dividend increases. And property values, especially in the office and apartment REIT sectors, have become quite frothy.

REITs currently trade at a 7% premium to their underlying property values, or net asset values (NAVs), according to Green Street Advisors Inc., a REIT research firm. That's not exorbitant by historical standards: The premium was 33% in 1997, right before 1998's slide. But it's not cheap either as REITs traded at a 20% discount when the sector bottomed in late 1999.

That 7% premium may also be under-

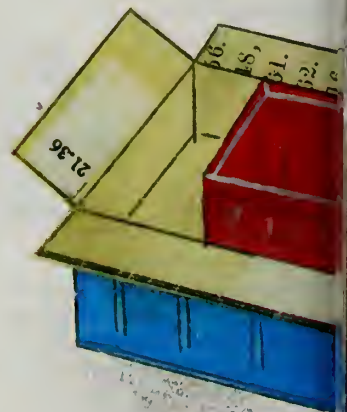
stated as a rash of buyouts last year helped push up NAVs. That's because unless the share price increases as much as the NAV, the premium falls. "Every time a REIT is taken out at a price significantly higher than its NAV estimates, analysts ratchet up their valuations," says Keven Lindemann, director of the real estate group at Charlottesville (Va.) researcher SNL Financial. He cites Blackstone Real Estate Partners' November buyout, at \$48.50 a share, of Equity Office Properties Trust. The high NAV estimate on the Street at the time was \$42 a share. "The only way the deal makes sense is if Blackstone thinks the real estate in a private sale would be worth \$60 a share," he says.

MALL SHOPPING

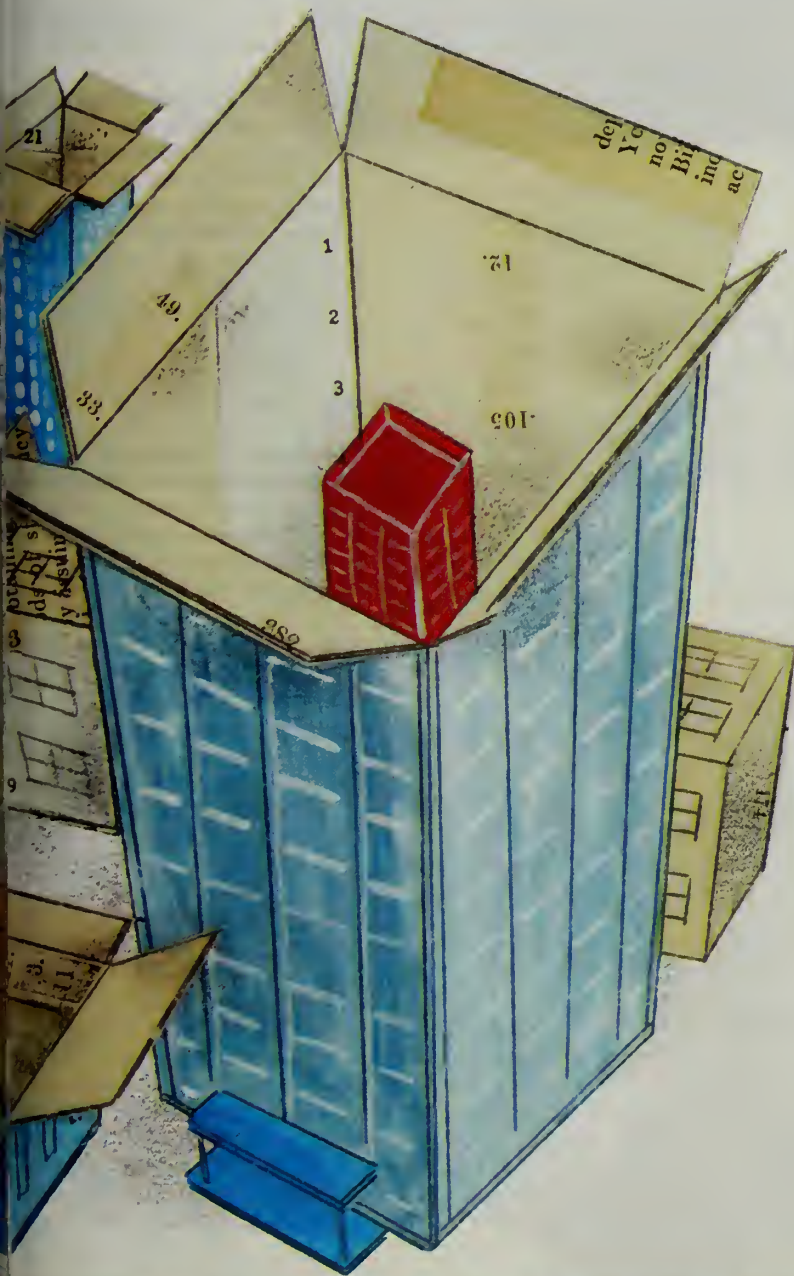
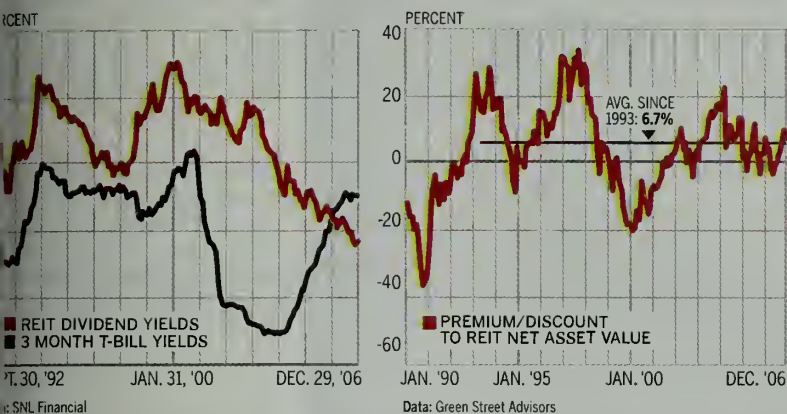
TO AN OPTIMIST, such acquisitions are an indication REITs may still have running room. To a more bearish investor, it could mean NAVs are now inflated.

Lindemann argues that REITs' status as an asset class separate from bonds or stocks justifies their increase in valuation, but they've taken on an increasingly important role in portfolios. "They've matured as an asset class to the point where pension funds allocate a separate portion of their portfolios to them," he says. "So there's a lot of capital flowing into the market."

REITs that own shopping malls are a group that seems more reasonably valued than the others. "They are operating in end malls where the consumer is still strong," says Mike Kirby, Green Street's director of research. He likes Simon Property Group, General Growth Properties, and Taubman Centers. Green Street's estimated 2007 price-operating earnings ratio for mall REITs is 24, vs. an estimated 20 for REITs and 15 for stocks in the Standard & Poor's 500-stock index. So they're c



INDICATORS SUGGEST A PULLBACK



than their peers but no screaming buy.

Some money managers have started to hit the exits. GMO, a Boston firm with \$127 billion under management, sold much of its REIT position at the start of 2006 after being bullish for years. "This was the first time since 1998 that we started to dislike REITs more than we disliked the rest of the stock market," says Ben Inker, GMO's director of asset allocation. Inker expects REITs' annualized total return for the next seven years to be -0.2%, even with dividends. The stock market, he predicts, will deliver 0.8%.

TRADING LIKE STOCKS

INTERESTINGLY, AS INVESTORS have piled in, REITs have begun to behave more like conventional stocks. Their plump yields, which served as a cushion during past downturns, are gone, and they've become more volatile and more correlated with stocks. "There are many days now where we see a 1% move in REITs," says Sam Lieber, who as CEO of Alpine Woods Capital Investors runs \$2.2 billion in real estate mutual funds. "We didn't see that previously." Exacerbating the problem: In recent years, REITs have been incorporated into broad market indexes such as the S&P 500, and large index funds now buy and sell them with the rest of the market.

Regardless of whether one views REITs as a real estate or a dividend play, there are alternatives. Many non-REIT companies own real estate yet don't command such rich valuations. Lieber favors hotel stocks, such as Hilton Hotels, Starwood Hotels & Resorts Worldwide, and Orient-Express Hotels, that don't have high yields but are considerably less expensive. On average, such stocks trade at 11 to 13 times Lieber's 2007 estimates for their cash flows, vs. the 17 to 24 times for the REITs he follows. He also thinks luxury hotel chains might become acquisition targets.

If your primary interest is yield, Lieber points to bank stocks such as US Bancorp and Bank of America, which have dividend yields of about 4%. They also have better prospects for earnings growth than REITs, since they can reinvest their profits.

Beyond stocks, GMO's Inker recommends Treasury Inflation-Protected Securities. Like real estate, TIPS' values rise with inflation. Currently, TIPS yield 2.3% plus the inflation rate. Inker expects a 4.8% annualized return for them through 2013.

Of course, no one suggests dumping REITs entirely. But until yields start to rise again, you may want to trim your REIT position and hold off on throwing any new money their way. ■



BICKEL He helps clients set up family foundations

Get 'Em Started Early

PNC's Bruce Bickel explains how to teach your kids money management and charitable giving

EVEN CHILDREN AS YOUNG as six or seven should learn about the responsibilities of wealth. So says Bruce Bickel, senior vice-president at the wealth management unit of PNC Financial Services Group in Pittsburgh. Since joining the bank in 1988, the plain-speaking U.S. Naval Academy graduate and former Baptist minister has built a national practice helping clients establish private charitable foundations. He also teaches families how to pass on philanthropic values to younger generations. Bickel discussed his ideas with correspondent Aaron Pressman.

When should people start talking to their children about what it means to be wealthy in a society with such a large gap between rich and poor?

Start in first grade. You want them to recognize early that wealth is a responsibility, not a right. So many families say to me that they're afraid their kids are going to have a poor work ethic. I encourage parents to talk with their children about the five areas of meaningful money

management—earning, giving, saving, spending, and budgeting.

How do you do that with young children?

You can take a pie chart and divide it into sections, showing how much is earning, giving, saving, and how the family income is spent on food, clothing, recreation, vacations, utilities, etc. Then, let the children create their own pie chart using their allowance as the in-

come base. This lets the parents teach about money management, which includes a "giving" component. The parents can discuss with the children what they would like to assist with their own giving.

What happens with older kids?

At age 17 or 18, the teens join the family foundation "in name." They come to the board meetings, they listen, and they participate. They have no authority, and they don't vote. When they turn 19 or 21 or 23, they have sat through all of the meetings, understand their beliefs and values, they understand the wishes of their mom and dad and what they want to represent.

What are you seeing in those kids coming into adulthood?

This generation, the 20-somethings, is looking for guidance. They've seen the frustrations and lack of satisfaction wealth can bring. I'm hearing a lot of them say they don't want the same things to occur in their lives. Again, we need to help them discover that the wealth they have, however it has come to their family, can be a wonderful blessing.

How do you help a wealthy family set up what their foundation should do?

I tell people I'm in the heart business. We help them create a mission statement with their beliefs and values. Then, when they want to leave comes out of the

Can you give an example of how a family got their children involved in their charitable endeavors?

One of my clients was on a family foundation in New York, and the little boy in fourth grade, saw a lot of street homelessness. He was touched by that, and one day he said: Can we help the homeless people of Pittsburgh? We arranged for the young lad to make an on-site visit with his parents to see how a grant from his family's foundation would be used to assist the homeless.

As a result of the experience, the boy talked with their younger daughter, a first grader, about where her interests were in helping people. She is very artistic and indicated she would like to help needy children be exposed to arts and crafts lessons. We arranged for the family to visit a foundation that provides that very service, and their foundation made a grant.

Young Donors in Training

Coaches and peer networks are helping kids of wealthy give wisely. **BY JESSI HEMPEL**

GROWING UP, JOS Thalheimer knew his family was wealthy. He lived in a mansion with tennis courts and a swimming pool. He went to Choate Rosemary Hall, an elite Connecticut boarding school. But his family, which inherited its wealth from a factory created when his great-grandfather founded the American Oil Co. in 1910, rarely talked to him about their money or what it meant. Although his father directed a family foundation that gave away \$1.5 million annually, Thalheimer didn't even learn about his late teens.

At that time, a family friend suggested that Thalheimer attend a program organized by Grand Street, a peer group for young Jews whose members are involved in philanthropy. "I was nervous," says Thalheimer, now 21, "but I had never talked about this stuff. I had never been in a room with other people where I'd said: 'I have money. I have money. I have money. I have money for myself.'" Thalheimer's experience is not unusual. In many families, there is a lot of silence about money, says David Schweser, donor program coordinator at Resource Generation, a nonprofit that helps young people with financial means to think about social change. "Parents are dealing with their own anxieties and fears related to money," he says. "Groups like his and Grand Street are sprouting

up to encourage families with money to talk about their values and how they can use their wealth to advance them.

Most community foundations, which help organize local philanthropies, offer advice on the technical aspects of giving, how to make grants, and how to get multiple generations to work together on these issues. The Silicon Valley Community Foundation, for example, offers coaching to families planning their philanthropies. It also runs Venture Van tours, which takes families to visit nonprofits to learn about community issues "without getting a sales pitch," says spokeswoman Michelle McGurk.

Firms such as the Rockefeller Philanthropy Advisors offer similar services. In addition to one-on-one counseling, they co-sponsor programs such as Generous Explorations, which introduces young people to local nonprofits and gives lessons in effective grantmaking.

SOCIAL CHANGE

RESOURCE GENERATION, based in New York, runs annual retreats called "Making Money Make Change." More than 60 young people ages 18 to 35 attend the sessions, which focus on the political, technical, and personal aspects of using financial resources to pursue social change. Monthly dinners in cities across the country allow members to talk about how to make their money do good. In February two Resource Generation alumni, Alison Goldberg and Karen Pittelman, will release a guidebook, *Creating Change Through Family Philanthropy: The Next Generation*, published by Brooklyn (N.Y.)-based Soft Skull Press.

Then there's Grand Street, operated by 21/64, part of the Andrea and Charles Bronfman Philanthropies. At its sessions, leaders toss out terms such as "justice" and "compassion" to prompt discussions among participants about what matters to them. The dozen or so members of each group are encouraged to keep in touch through regular meetings, conversations, and even trips during the year.

"With my inheritance, I felt a sense of guilt and responsibility," says Thalheimer. "Now I'm able to push issues in my own family and to talk about [my background] with other people." He has begun supporting Jewish causes and giving to his alma mater, New York University. In a few months, he will assume a more involved role in his family's foundation. ■

Doing Good

Groups that can assist with the first steps:

GRAND STREET (2164.net)

Convenes young Jews age 18 to 28 who plan to get involved in their family's philanthropy

LEVERAGING PRIVILEGE FOR SOCIAL CHANGE (Yesworld.org)

Brings together 30 young people under 30 to discuss privilege and social change

RESOURCE GENERATION

(Resourcegeneration.org)

Gathers those age 18 to 35 who have wealth to discuss using their resources to promote social change





BY GENE G. MARCIAL

EVEN WITHOUT A DELTA DEAL, US AIRWAYS' STOCK MAY TAKE

UCBH HOLDINGS IS AIMING TO BUY A LOCAL BANK IN CHINA.

STENTMAKERS TURN TO VASCULAR TECHNOLOGY FROM VOLC

US Airways Is the Ticket

WITH EVERYTHING THAT'S going on in airlines, how do you play them? US Airways (LCC) is the way to go, argue some pros. On Jan. 10 the company raised its bid for Delta Air Lines to \$10.5 billion. Delta, which had spurned an earlier US Air offer, wants instead to merge with Northwest Airlines, also in bankruptcy. The Street isn't optimistic that US Air will win out because Delta management and labor are so hostile toward US Air. No matter. "With or without Delta, US Airways will be a winner," says Vince Carrino, president of Brookhaven Capital Management, which owns shares. "If it fails to win Delta, US Air itself will be a target," he believes. Its assets, particularly its extensive domestic routes, should attract the other majors, including American, Continental, and United, says Carrino. Daniel McKenzie of Credit Suisse isn't so sure US Air will be an easy target, but he rates it a "buy," based on valuation alone. It is cheap, he says, so he has raised his 12-month target for the stock, already up from 37 in August to 58.79 on Jan. 17, from 72 to 76. US Airways has other options, he notes, such as buying some Northwest hubs to complement its domestic structure. McKenzie figures earnings will jump to \$7.70 a share in 2007 from an estimated \$5.59 in 2006, vs. a loss of \$5.99 in 2005. Another bull, Ray Neidl of Calyon Securities, has raised his rating from "add" to buy, based on strong demand and stable oil prices. If a merger happens, he says, "it will add momentum" to the stock.



A San Francisco Chinatown Bank Heads for the Mainland

NOT ONLY THE MAJOR BANKS are taking aim at China's huge market. San Francisco's smaller UCBH Holdings (UCBH), owner of United Commercial Bank, which caters to many Chinese Americans, is eyeing a buy in China. UCBH, which already has a branch in Hong Kong, qualifies to own a Chinese bank, having boosted its assets this year to the required \$10 billion. UCBH Executive Vice-President Jonathan Downing says China "holds the key to our growth strategy, partly because of our experience and connections with the Chinese community." He sees a

huge opportunity in financing trade for small businesses in China. Joe Morford of RBC Capital Markets, who rates UCBH "outperform," says the bank plans to expand its business in China from 2% of total earnings to 20% or more in 5 to 10 years. UCBH stock, now at 17.70, "is our top pick in small caps," based on valuation and strong growth prospects, says James Abbott of Friedman Billings Ramsey.



How Growth Could Erupt at Volcano

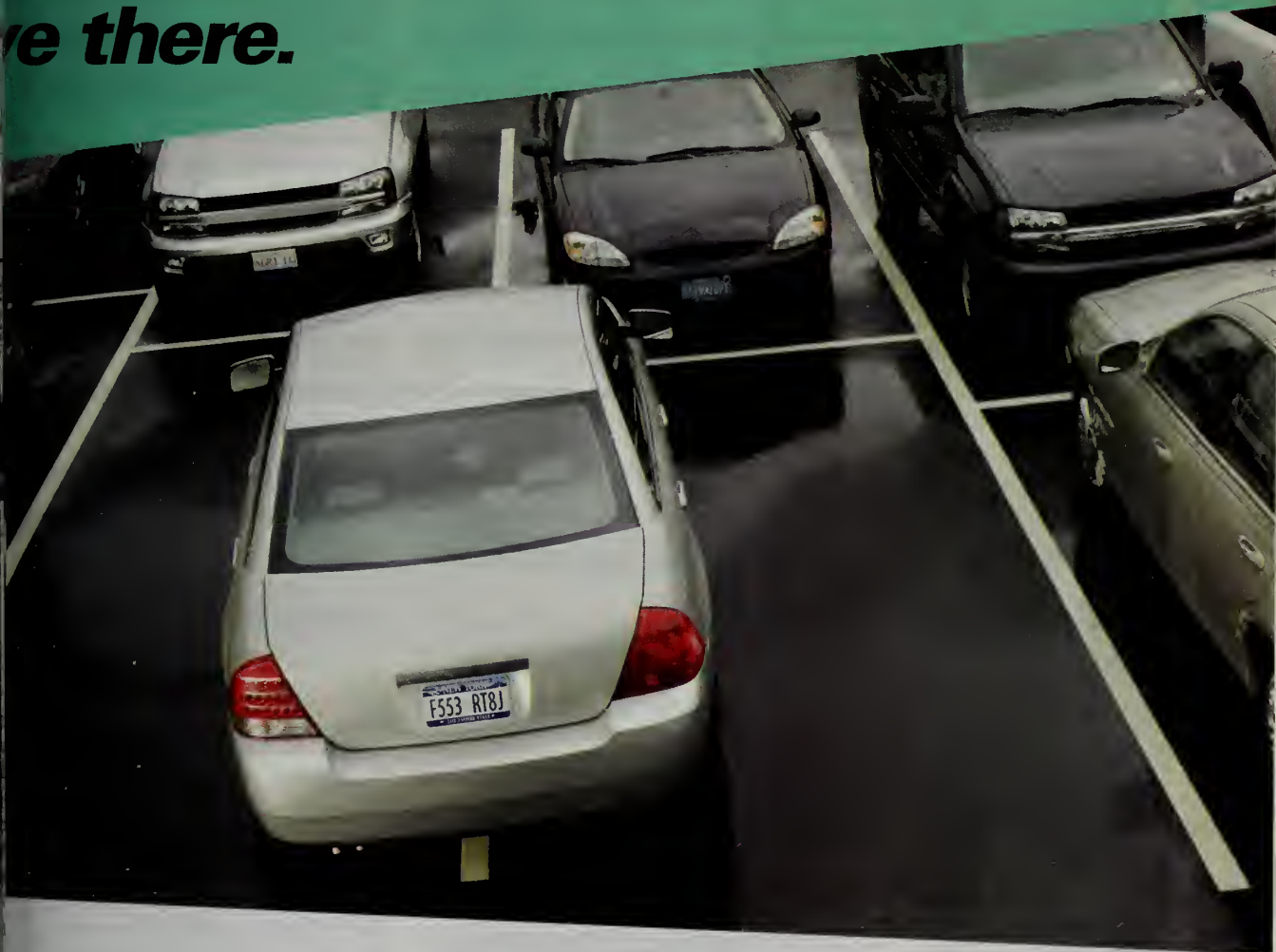
WORRIES ABOUT drug-coated stents are drawing attention to Volcano (VOLC), a maker of intravascular ultrasound (IVUS) catheters and devices for diagnosis and treatment of heart disease. Volcano went public in June 2005 and has galloped to 18.81. The company is poised "for explosive growth because of its leading technology," says Robin M. West of the New Mexico State Investment Council, which owns shares. An IVUS device shows where stents are placed in an artery and points up when they are improperly positioned, potentially causing thrombosis. On Dec. 7, Volcano, working with Stanford University and the Cardialysis & Cardiovascular Research Foundation, agreed to supply IVUS gear free of charge for clinical trials of stents. The goal is to see the long-term safety of current and next-generation stents. West figures Volcano "will attract a buyer before long." It has teamed up with other companies, including Medtronic, which owns 2.3%. Johnson & Johnson owns 4.6%. West predicts the stock will climb to 25 this year. Jose Haresco of Merriam-Cuahan Ford, who rates it a buy, sees Volcano turning profitable in 2008, with 30¢ a share on sales of \$136 million, vs. an estimated 1¢-a-share loss in 2007 on \$118 million. In 2008, he expects 51¢ on \$151.6 million. ■



BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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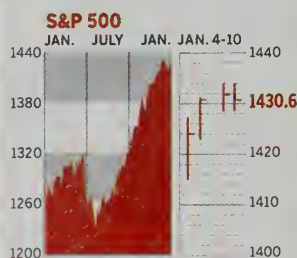


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STOCKS



COMMENTARY

Markets rose as earnings reports trickled in. Alcoa's report boosted its stock 7%, while an analyst's upgrade helped Procter & Gamble rise 3%. The falling price of oil helped buoy the shares of heavy users FedEx and DuPont. Intel's shares took a hit when its earnings failed to impress. Cisco Systems shares fell 5.9% after it was downgraded.

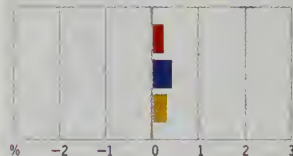
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED JAN. 16

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED JAN. 16

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	JAN. 17	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1430.6	1.1	0.9	11.5
Dow Jones Industrials	12,577.2	1.1	0.9	15.4
NASDAQ Composite	2479.4	0.8	2.7	7.7
S&P MidCap 400	818.9	1.6	1.8	7.3
S&P SmallCap 600	401.0	1.5	0.2	10.0
DJ Wilshire 5000	14,357.2	1.2	1.0	11.5

SECTORS

BusinessWeek 50*	8079	1.5	1.2	3.8
BW Info Tech 100**	452.9	1.5	1.2	14.5
S&P/Citigroup Growth	660.8	1.2	1.3	7.6
S&P/Citigroup Value	768.1	1.0	0.5	15.6
S&P Energy	429.8	1.9	-5.7	4.5
S&P Financials	497.8	0.7	0.5	14.9
S&P REIT	207.0	3.0	4.1	29.6
S&P Transportation	268.2	3.1	1.7	9.8
S&P Utilities	182.9	-0.4	-2.0	10.8
GSTL Internet	199.9	-0.6	0.1	-5.3
PSE Technology	901.2	0.3	2.9	3.2

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	JAN. 17	WEEK
S&P Euro Plus (U.S. Dollar)	1981.3	2.1
London (FT-SE 100)	6204.5	0.7
Paris (CAC 40)	5561.8	1.1
Frankfurt (DAX)	6701.7	2.1
Tokyo (NIKKEI 225)	17,261.4	1.9
Hong Kong (Hang Seng)	20,064.6	2.5
Toronto (S&P/TSX Composite)	12,730.4	2.2
Mexico City (IPC)	26,558.5	2.6

FUNDAMENTALS

	JAN. 16	WEEK
S&P 500 Dividend Yield	1.77%	1.7%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	17.7
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	14.7
First Call Earnings Revision*	5.93%	8.3%

TECHNICAL INDICATORS

	JAN. 16	WEEK
S&P 500 200-day average	1323.5	1321.1
Stocks above 200-day average	73.0%	70.1%
Options: Put/call ratio	0.71	0.71
Insiders: Vickers NYSE Sell/buy ratio	6.10	6.10

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	25.7	Steel	64.3
Real Estate Mgt. & Dvpt.	12.3	Broadcasting	40.9
Automobiles	9.1	Constr. Materials	40.8
Health-Care Services	7.2	Investmt. Bnkg. & Brkrge.	40.4
Office REIT's	7.1	Motorcycles	39.9

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Equipment	-13.9	Gold Mining	
Oil & Gas Drilling	-10.8	Homebuilding	
Coal	-10.3	Education Services	
Gold Mining	-9.9	Oil & Gas Refining	
Gas Utilities	-9.2	Internet Software	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Pacific/Asia ex-Japan	4.8	Pacific/Asia ex-Japan	34.1
Real Estate	4.7	Real Estate	32.1
Diversified Pacific/Asia	2.8	Latin America	30.8
Technology	2.8	Europe	27.2
LAGGARDS		LAGGARDS	
Natural Resources	-7.3	Japan	-2.9
Precious Metals	-3.8	Natural Resources	-0.5
Utilities	-1.8	Health	4.8
International Hybrid	0.1	Technology	4.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Dreyfus Prem. Grtr. China A	11.9	Dreyfus Prem. Grtr. China A	76.2
Frontier MicroCap	11.8	Oberweis China Opport.	66.6
Matthews China	11.2	Old Mut. Clay Finlay Ch. A	66.1
iShares MSCI Malaysia Idx.	10.2	iShares FTSE Xha. Ch. 25 Idx.	62.3
LAGGARDS		LAGGARDS	
ProFunds Oil Equip., Svcs.	-16.3	Ameritor Investment	-85.7
Dunham Real Estate Stock C	-15.2	DireXn. Emrg. Mkts. Short	-43.3
Dunham Small Cap Value C	-14.9	BlackRock Real Invest. C	-28.1
BlackRock Real Invest. C	-14.5	Rydex Commodities H	-27.6

INTEREST RATES

KEY RATES

	JAN. 17	WEEK
Money Market Funds	4.86%	4.8%
90-Day Treasury Bills	5.11	5.0%
2-Year Treasury Notes	4.90	4.8%
10-Year Treasury Notes	4.78	4.6%
30-Year Treasury Bonds	4.87	4.7%
30-Year Fixed Mortgage†	6.11	6.0%

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	3.86%
Taxable Equivalent	5.51
Insured Revenue Bonds	3.99
Taxable Equivalent	5.70

THE WEEK AHEAD

LEADING INDICATORS Monday, Jan. 22, 10 a.m. EST » The Conference Board's December leading economic indicators index is forecast to have increased by 0.1% for a third straight period as stock prices continued to rally and weekly jobless claims slowed. That's according to the consensus forecast among economists surveyed by Action Economics.

EXISTING HOME SALES Thursday, Jan. 25, 10 a.m. EST » Existing

home sales in December very likely cooled to an annual rate of 6.25 million units. Sales in November had accelerated to an annual rate of 6.28 million. Mortgage rates kept drifting lower in November but reversed course during December.

DURABLE GOODS ORDERS Friday, Jan. 26, 8:30 a.m., EST » In December, durable goods orders are expected to have jumped 1.2%. Orders in November

rebounded with a 1.6% gain. The November increase was driven by a 53.4% turnaround in orders for computers.

NEW HOME SALES Friday, Jan. 26, 8:30 a.m. EST » New home sales probably stayed virtually unchanged at an annual rate of 1.05 million in December. During November, the pace of sales improved, pulling down the number of unsold new homes for a fourth straight month.

The *BusinessWeek* production index jumped to 288.9 for the week ended Jan. 6, a 6.5% increase from the previous week. Before calculation of the week moving average, the index surged to 293.9.

BusinessWeek

For the BW50, more invest and the components of the index visit www.businessweek.com/e

Company Index

Index gives the starting page for a story or feature with a significant presence to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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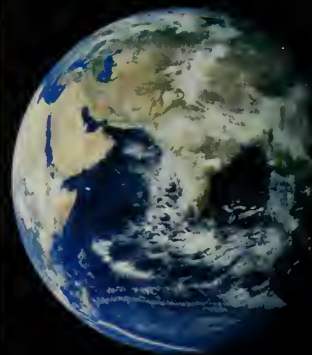
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Hardly Babes in Toyland

THE REAL TOY STORY Inside the Ruthless Battle for America's Youngest Consumers

By Eric Clark; Free Press; 259pp; \$26

Each February, thousands of toy manufacturers, retailers, promoters, and dreamers descend on New York for the industry's mammoth Toy Fair. Many come lugging new toy samples—some no more than models in Styrofoam and glue—that they hope will make it to retailers' shelves and little kids' hands

by Christmas. It's an inspiring and amusing phenomenon: There's something incredibly cute about grown-ups trying to pitch the next Cabbage Patch Kids or Easy-Bake Oven. But, alas, in Toyland, as in almost every industry, dark forces are at work.

Those dark forces are what British investigative reporter Eric Clark seeks to expose in *The Real Toy Story: Inside the Ruthless Battle for America's Youngest Consumers*, billed by his publisher as a *Fast Food Nation* for the Beanie Baby biz. Clark describes a world in which giant corporations, struggling to cope with retail consolidation and children's waning interest in traditional toys, slug it out in a global version of Rock'em Sock'em Robots. Foremost among the toymakers' heinous deeds is the exploitation of low-cost workers in China. On top of that, they employ TV, the Internet, and even slumber parties seeded with products to turn children into toy-hungry tyrants, destined to nag their parents into purchasing the latest It'll Keep Them Busy for 20 More Minutes Elmo.

My problem is this: Does anyone not know these things? Isn't all this a bit like telling parents there is no Santa Claus?

Still, Clark's volume provides a colorful overview of the \$22 billion toy business and the challenges it faces. For one thing, kids are getting older faster, as the industry expression goes. They very quickly jump from dolls and toy trucks to computers, iPods, and video games. That's why toy sales have been lagging for the past few years. To make matters worse, discounters Wal-Mart, Target, and Kmart have come to control the lion's share of the business, while retailers such as Toys 'R' Us and FAO Schwarz are struggling. Pricing pressure brought by these big merchants forces large toymakers to seek out lower-cost labor overseas. Meanwhile, small producers find it ever tougher to get distribution.

Clark offers a whirlwind history of toy advertising on TV. That begins with two critical events from 1955: the first

televised toy commercial, for Hasbro's Mr. Potato Head; the decision by Mattel's Elliot and Ruth Handler to pour up their company's entire \$500,000 net worth to purchase a year of advertising on a new ABC show called *The Mickey Mouse Club*. The emphasis on TV advertising turned out to be only the first step in toymakers' evolution into entertainment companies. In 1984, Hasbro transformed the industry with Transformers—a line of shape-changing robots that simultaneously appeared in the U.S. as toys, comic books, and an animated TV program. Today, royalties from toys provide critical funding for even public TV shows such as *Sesame Street*. Mattel, meanwhile, releases feature-length

DVDs starring Barbie.

In his final chapter, Clark visits China as he calls it, Santa's Sweatshop. Rather than cite the experiences of real employees, Clark only produces a composite, whom he calls Mei. The 18-year-old factory worker in Guangdong province suffers from a range of workplace disorders, including open cuts on her hands and rashes from the toxic chemicals she is exposed to at the plant. Just to obtain her job, which pays about \$1 a day, she had to bribe a supervisor. Workers like Li Mei sometimes sleep two to a bed, in company-owned dormitories. They get charged extra for their physicals, employee ID cards, and even a newspaper. To meet quotas as high as 4,000 a day, Li Mei must work night shifts, when she gets fined if she dozes off.

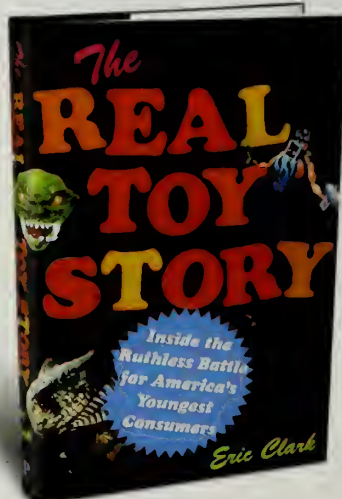
Working conditions in China can be reprehensible, and Clark is to be applauded for reminding the world of that. But what's likely to stay with readers are Clark's anecdotes about how many well-known toys and games got their start. Did you know that Lincoln was created by architect Frank Lloyd Wright's son, who was inspired by his father's design for Tokyo's Imperial Hotel? That Play-Doh was developed

An exposé that's a bit like telling parents there is no Santa Claus

first as a cleaning compound for wallpaper? Slinky, it turns out, was the brainchild of a naval engineer, who was inspired by a large torsion spring that he saw on a ship.

The present-day counterparts of such inventors represent the strong suit that the toy business will rely on to survive the powerful waves of consolidation, globalization, and competition from consumer electronics. And they'll all be at Toy Fair in February—glue guns in hand. ■

—By Christopher P.



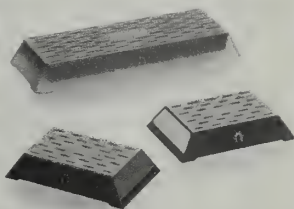
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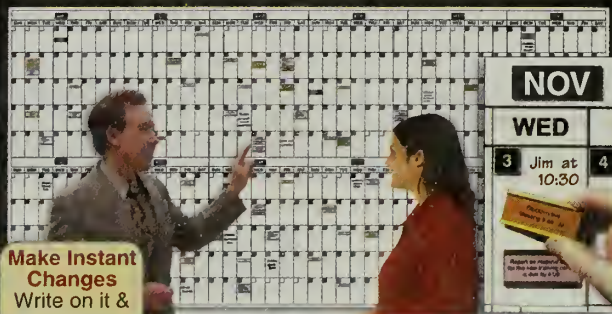
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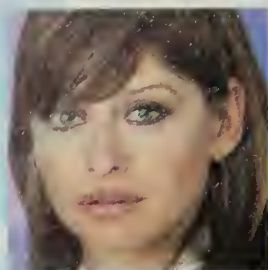


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What to Expect at Davos

FOR MORE THAN 35 YEARS, the Swiss businessman, economist, and philanthropist Klaus Schwab has been the driving force behind the World Economic Forum in Davos, where thinkers gather to ponder the problems of the planet. And with the world beset by more ills than Job, there is no shortage of issues for CEOs, prime ministers, and academics to wrestle at this year's "Annual Meeting" from Jan. 24-28. I talked with Schwab about what will be on the table.

What are the most important issues facing the world economy?

The World Economic Forum did some research, together with Citigroup and Marsh & McLennan, to keep track of major global risks, and we have identified 23 different risks, such as global warming, terrorism, oil price shocks, a hard landing for China, and so on. All of those issues will be on the agenda. Davos has one specific function: It looks at all the issues on the global agenda, trying to see priorities and find solutions. There will be 2,400 people—half business, half other stakeholders in the global society, including 25 heads of state. You have practically every major government represented.

Last year, India was a big focus, as was innovation. What will the hot topics be this year?

Priorities evolve during the meeting itself. But a general issue will be the changing power equation, which means that everywhere in society and business, the power is moving from the center to the periphery. Vertical command-and-control structures are being eroded and replaced by communities and different platforms. We are moving into the Web 2.0 world, and this has tremendous implications on the national level and on business models. Also, three countries could be in the limelight: Russia, because the whole issue of energy security is at the top of the agenda; Vietnam, which is a new preferred

place of investment; and Mexico, with the new President ing. And even if we are moving more and more into a country world, the U.S. is still the key actor. We will delegation of 12 senators, and [issues will be] the sustain of U.S. economic growth and the risk of the falling dolla

Are you expecting to see much talk about the American Presidential race?

In the context of Davos, the interest is not so much wh be the person leading the U.S. We don't want to have a show of Presidential candidates, even if some candidat [Senator John] McCain will be there. It's much more ab direction of American policies, because the world canno

two years [for a new President next two years will be very deci we don't discuss and solve the c between Israel and Palestine, the will look very different in 10 year

Your thoughts on Iraq and the Middle East today?

It's not just an American challenge a challenge for the world, beca Iraq goes into chaos and tribalis repercussions for the Middle Ea the energy supply, will be treme We believe Davos is a platform fo tive interaction between the di factions in Iraq.

How does the rest of the world view the U.S. today?

In my opinion, anti-Americanis decreased. One reason is that U.S. there is a much more vibra

SCHWAB A major theme will be the power shift from the center to the periphery

cussion about the future. Americans are asking thems lot of questions.

Is Davos a bit more of a celebrity fest than you originally intended?

Of course, Davos is a place for business and political c ties, and we have invited Hollywood celebrities becau have been very associated with some social causes. We invite them because they were famous. This has brou more reports in the popular media. This year we ma decision that, with the exception of one or two people, w not inviting any Hollywood celebrities. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.



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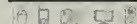
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

Hiring Wrong—and Right

How fast should you move when you sense you've made a hiring mistake?

—Magdalena Fernandez, Santiago, Chile

In a word, very. So fast, in fact, that if you're moving at the right speed in taking care of a hiring mistake, it will probably feel too fast. That's O.K. In every case, a rapid intervention is better for the organization, your own career, and even the person you're letting go.

Look, hiring great people is brutally hard. New managers are lucky to get it right half the time. And even executives with decades of experience will tell you that they make the right calls 75% of the time at best.

The problem is, the stakes are so high. Never has it been so important to field a team with the best players. Every smart idea matters. Every ounce of passion makes a difference. You cannot have a black hole in your organization where a star should be.

So that's the first reason you need to face up to hiring mistakes quickly. Sure, maybe one individual's poor performance won't sink the company. But when your "mistakes" aren't doing their jobs, it invariably puts a strain on the whole team and makes work harder for everyone else. So resentment toward the underperformers—and toward you for hiring them—builds up.

And yet, as your question implies, too many managers procrastinate for too many months before acting on their hiring mistakes. They'll tell you they're hoping the mistake's performance will improve with time and experience. They might also moan about the time that's required to find someone new and bring him up to speed.

BUT THE REAL, UNSPOKEN REASON most managers don't act is that they fear looking stupid and worry that admitting they made a hiring mistake is career suicide. In any good organization, that logic is exactly backward. Any company worth its salt will reward managers when they acknowledge they've hired wrong and swiftly repair the damage. They get more positive buzz for the operational improvements that occur when the right person is finally in place. Indeed, recognizing mistakes—and fixing them boldly—builds a manager's credibility. Hoping against hope that the mistake will go away does the opposite.

Now, it is important to note that "boldly" doesn't mean harshly. Remember: You made the error. Don't blame the

person who persuaded you that he was right for the job. Break the news candidly, take responsibility for what went wrong, make a fair financial arrangement, and then give the departing employee time to look for a soft landing somewhere else. Both you and the person you hired need to feel as if you handled everything properly, especially should you ever meet again when your former "hiring mistake" happens to become a potential customer.

Of course, the best way to handle hiring mistakes is to hire them in the first place. Yes, bringing in the right person is, as noted above, a tough business fraught with pitfalls. But you can really improve your chances if you fight like against the three main hiring impulses that most often get managers into trouble.

**Fight like hell
against the
three hiring
impulses that
get managers
into trouble
most often**

The first is using your gut. Don't! When you have a big, crucial job opening to fill, it's just too easy to fall in love with a shiny new candidate who is on his best behavior, telling you exactly what you want to hear and looking like the answer to all your prayers. That's why you can never hire alone. Make sure a team coolly analyzes the candidate's credentials and conducts interviews. And by all means, make sure the team includes at least one real hard nose—the kind of naysayer who is particularly good at sussing out the job fit and sniffing out the phonies.

The second instinct you have to fight is what we call the "recommendation reflex," in which managers rationalize away negative references with excuses like: "Well, our job is different." You should seek out your own references to call, not just the ones provided by the candidate, and force yourself to listen to what they have to tell you even if it ruins the pretty picture you're painting in your head.

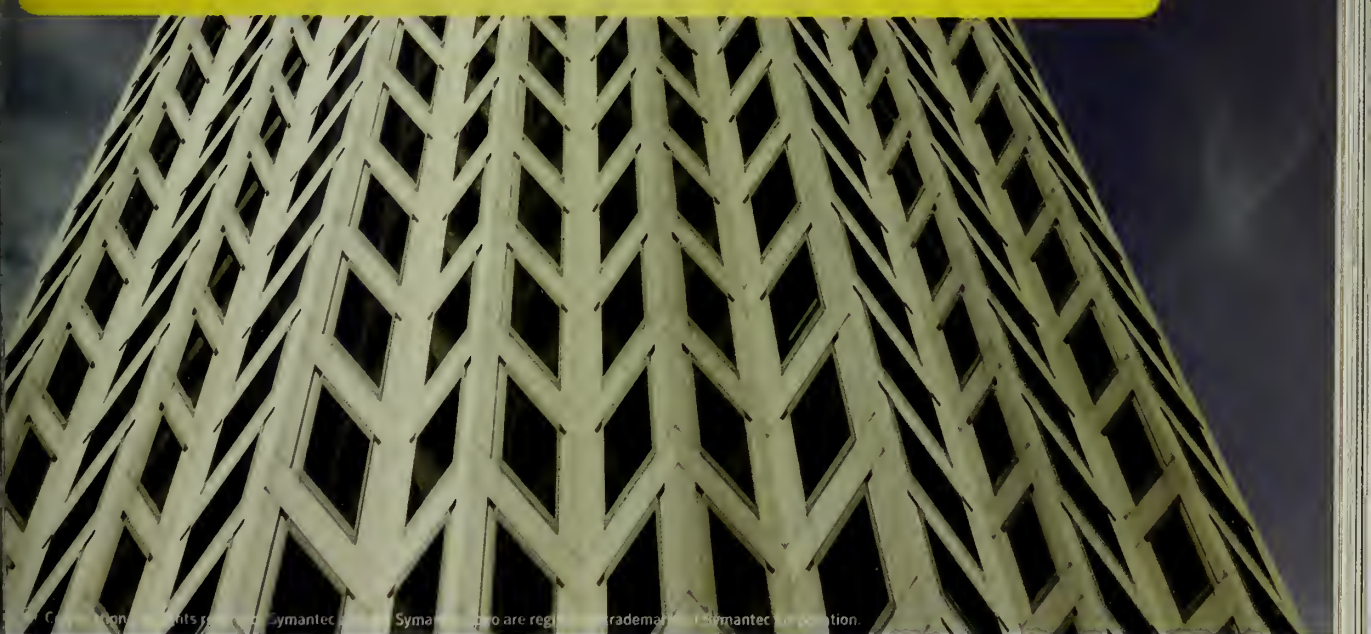
Finally, fight the impulse to do all the talking. Yes, you want to sell your job, but not at all costs. In interviews, ask candidates about their last job—and then shut up for a good, long while. As they describe what they liked and what they didn't, you will likely hear much of what you really need to know about fit.

True, you may still make a mistake, but at least it won't be because you rushed. Save the speed for fixing things if they unfortunately go awry. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

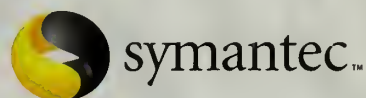


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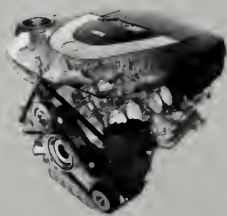


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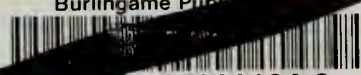
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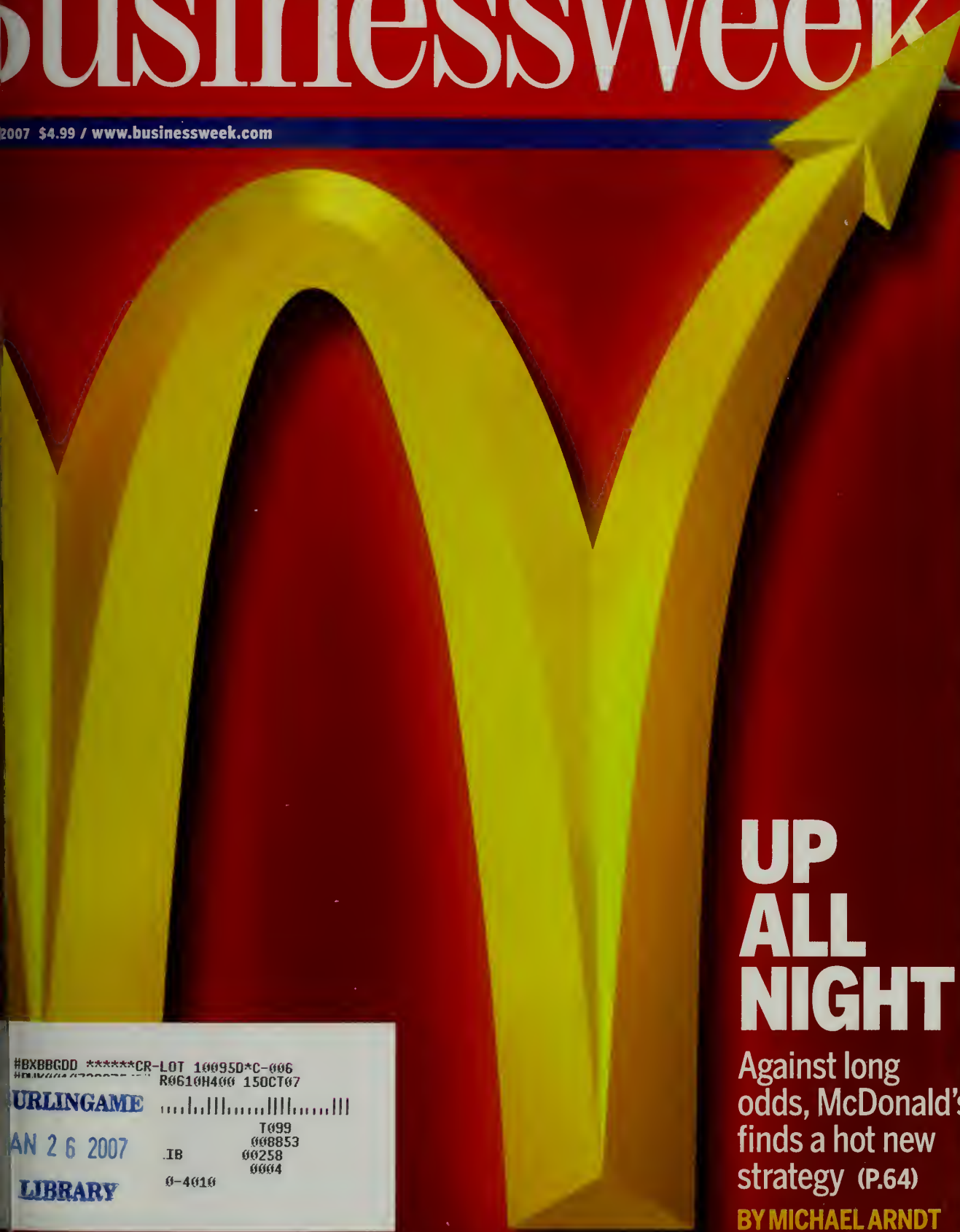
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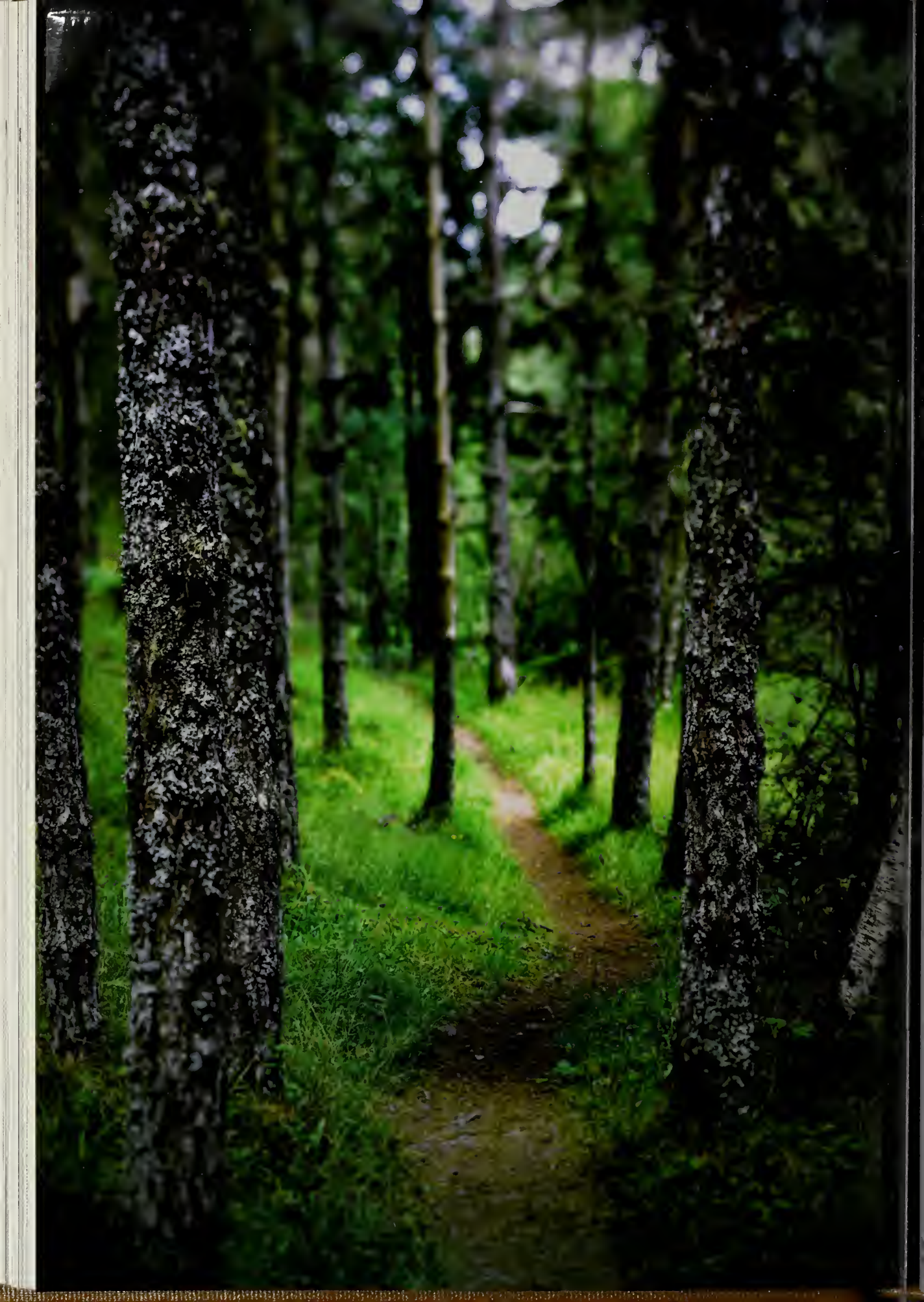


UP ALL NIGHT

Against long odds, McDonald's finds a hot new strategy (P.64)

BY MICHAEL ARNDT

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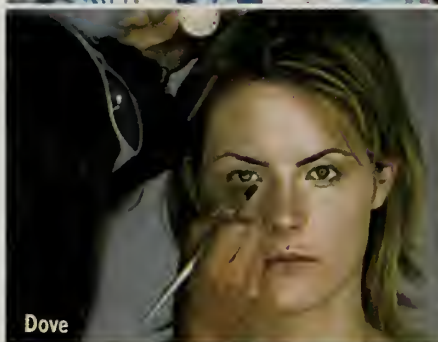
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The Joy of Viral Video

Online video isn't just for the YouTube crowd anymore. A growing number of companies are turning to viral video, and the word of mouth that accompanies it, for everything from advertising to recruiting to training. BusinessWeek.com's **CEO Guide to Technology** looks at how companies such as Coca-Cola, PepsiCo, Sony, and Intel are experimenting with video on the Web to build brand buzz, lower advertising costs, and reach millions of potential customers around the world. Our slide show captures some of the **wacky viral videos** already on the Web. In a podcast, blogger Robert Scoble talks about why video blogging can be a powerful tool for both executives and politicians. The read about how a lawyer and a professional juggler filmed son Diet Coke bottles exploding in the backwoods of Maine and became an overnight Internet sensation, ultimately scoring **de with Coke and Mentos** and an appearance on the *Late Show with David Letterman*. Go to www.businessweek.com/technology/ceo_gi for all this and more.

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Front

"I am trying to focus on the positive side."

—Citigroup CEO Charles O. Prince III after recent high-level management shakeups and amid continued lackluster financial results, as reported by The New York Times.

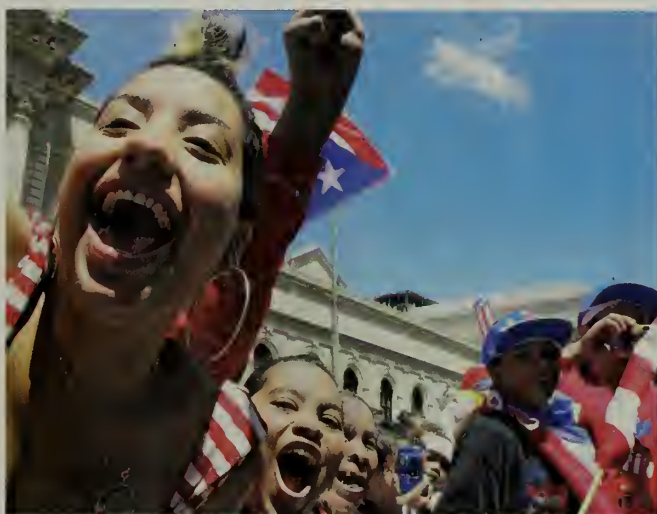
BY ERIC SCHINE

MARKETING

Fiesta Time at Goldman

AT Hispanic street fairs across the country, of immigrant and Latino throw back live music, and everything from as to fresh mangoes. Goldman Sachs wants a fiesta. Over the years the company's bank plans to invest as much as \$50 million in marketing and other companies that are growing Hispanic in the U.S., even street fair operators.

By every ad estimate Goldman has a Hispanic market. Goldman will be to unite a group of marketing and talent outfits into a company that will be a single stop for big companies navigating the market, but increasingly so. Even competitors concede



Goldman is on to something. "Clients are all asking for integrated services," says Carl Kravetz, president of the Association of Hispanic Advertising Agencies and CEO of Los Angeles-based cruz/kravetz:IDEAS.

At the outset, Goldman is looking to snare one of the 30 to 40 independent

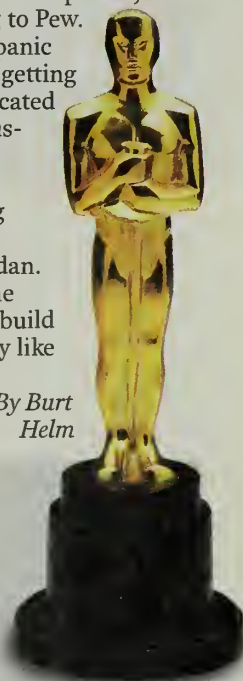
Hispanic ad agencies that annually generate between \$25 million and \$100 million each in billings, plus a research firm and a festival producer. Goldman will be majority shareholder with management handled by Latin Force, a marketing consultancy. The idea is to tap into second-generation

Latinos. Young and bilingual, they consume mostly English-language media but still retain aspects of their parents' heritage.

By 2010 the number of these "New Generation" Latinos could reach 15.4 million, according to the Pew Hispanic Center in Washington, D.C. Practically all growth in the coveted 18- to 34-year-old demographic comes from Hispanics, according to Pew.

"The Hispanic market is getting so complicated and confusing," says Goldman Managing Director Kevin Jordan. "That's the reason to build a company like this."

—By Burt Helm



BIG PICTURE

SHING THE ENVELOPES

Tonight, Hollywood's Best Kept Secret Award surely goes to a six-member team of hard-working PwC accountants. Charged with counting the ballots and keeping them safely padlocked overnight, the PwC crew puts in ten 12-hour days in the weeks leading up to the Oscars. They even commit the numbers to memory, in case one of those starry-eyed presenters loses the envelope. Here's a behind-the-scenes look at Hollywood's most sacrosanct ritual:

100,000 "PERSON-HOURS" IT TAKES PWC TO COUNT AND VERIFY THE BALLOTS BY HAND.

100,000 BALLOTS COUNTED BY PWC DURING 73 YEARS ON THE JOB.

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SPIN DOCTOR

A WORD OF ADVICE FOR CEOs

He persuaded the public to hate the soak-the-rich estate tax by redubbing it "the death tax." His insights nudged voters to support Newt Gingrich's 1994 Contract with America. Can pollster and spinmeister Frank Luntz get Corporate America to forgo bizspeak? "If you're eBay CEO Meg Whitman, why must you



say that you're 'encouraged by the fundamentals that underlie usage growth on the Net' when you could say that you're happy that more people are using the Internet?" asks Luntz in his new book, *Words That Work: It's Not What You Say, It's What People Hear* (Hyperion). "The message is targeted to CEOs," Luntz told *BusinessWeek*. "Start speaking the language of Americans." He advises corporate clients via Luntz, Maslansky Strategic Research, an Omnicom Group unit.

And what thoughts can Luntz offer the embattled GOP? Awkward language can't explain all its woes, he says in the book. "There was Iraq." —Hardy Green



COPYCATTLE CLONES, CLONES ON THE RANGE

IN LATE December, the FDA issued an 800-page report concluding that meat and milk from cloned cattle are safe for consumption, and asked for comments. Here's one from Steve Mower: "They're delicious."

Mower is marketing director for **Cyagra**, a small biotech company in Elizabethtown, Pa., that has been participating in cloning trials for the FDA. Cyagra raised 11 naturally born cows

and 11 copycattle (same breed, age, sex, and weight). After receiving the same diet for 60 days, all were slaughtered, and cuts of beef from each were sent to an independent lab. Cyagra researchers say tests found the cloned meat to be indistinguishable from normal beef.

And so do the palates at Cyagra: Complying with a voluntary ban on selling cloned meat, and loath to waste the food they raised, the scientists sold cuts from the standard cows to a butcher and rented a meat locker to keep the rest. Now they regularly pick up a cut of clone to bring back to the office for Friday lunches. "We started

with the steaks, which we grilled all summer, and now we have hamburger," says receptionist Shirley Trim who does the cooking.

Don't expect to enjoy Frankenburgers yourself anytime soon. While he is on the FDA's giving approval this year, the agency has its critics. It relies on results "from just about animals" in all, says Jos Mendelson, legal director of the **Center for Food Safety**, an environmental conservation group. Besides, creating a cloned cow costs at least \$16,000. For now, livestock owners say, almost all are used as breeding stock.

—Pallavi

PICKUP WARS WILL TEXANS NOW TAKE TO TOYOTA?

GET READY for a good ol' fashioned Texas shoot-out. Next month, Toyota's new factory in San Antonio will start turning out the company's new Tundra pickup. With the Tundra, Toyota finally has a full-size truck that can compete with the Big Three.

An earlier, smaller model never sold well, garnering just 5% of the Texas truck market, far behind Ford's 36% market share and GM's 32%. But the new Tundra, priced from \$22,300 to \$42,000, is much larger and sports a brawny

V-8 engine—just the kind of beefy pickup Texans love. And the new factory will be able to crank out 200,000 Tundras a year, a 50% increase.

Ford is shooting back. On Jan. 23, Chairman Bill Ford showed up at San Antonio's oldest Ford dealer, Jordan Ford, to open a new showroom. And to stir up passion for its new F-Series truck, Ford is putting a Texas flag badge on the side of the pickup and offering oodles of discounted chrome. It invited 14,500 of its truck owners to a free concert in San Antonio featuring country singer Toby Keith. Ford has even started a program to give out a "Built Ford Tough" award to the



state's high school football player of the week.

The Texas pickup war could get ugly. Ford recently made a TV ad showing the most of the workers at a construction site for Toyota's new plant owned Ford. The spot, though, never explains Mark Grueber's strategic marketing maneuver for the Southwest: "We to act like we're the lead

—Davie

**Our Blueprint
for America
is actually
quite green.**

year the American Institute of Architects (AIA) is celebrating its 150th anniversary with a nationwide community initiative, Blueprint for America. AIA architects, donating their time and expertise, are collaborating with citizens and implement ways to enhance their communities. Over 150 projects have been funded, tackling issues ranging from environmental sustainability to homelessness to disaster preparedness. For 150 years, members of the AIA have worked to create more valuable, healthy, secure, and sustainable buildings and cityscapes. What better way to celebrate our past than by helping America's communities design better, more sustainable futures? Learn about every project for America project, and other ways the AIA is celebrating its anniversary in your community, at www.aia150.org.

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SING OUT GET SOME HELP NAMING THAT TUNE

MYSPACE IS hot. iTunes is hot. So, of course, is Google. Run them through the Web 2.0 blender and you get **Midomi.com**, a song search engine-cum-social networking site created by **Melodis**, a Sunnyvale (Calif.) outfit co-founded by four Stanford University grads, led by CEO Keyvan Mohajer.

Can't remember a song's title? Hum, sing, or play a few bars into a computer mike or mobile phone, and Melodis technology can name that tune—a feature it's pitching to music e-tailers. To showcase that technology, the startup—slated to unveil



itself in late January—created Midomi.com as a kind of virtual karaoke bar.

Those who sign up as members can sing any of more than 10,000 tunes into the search engine, then see a menu of versions sung by other Midomi-ites (versions they can rate). Or they can buy commercial versions for 99¢ a pop from **Passalong**, a music seller. The

searchable tunes include everything from Maroon 5's *She Will Be Loved* to Hava Nagila. The number of tunes should explode, the site's co-founders say. "We're letting the world create our database, just like with Wikipedia," says Mohajer. After touring the site, 20-year-old New Yorker Rachel Cohen effused: "It's like *American Idol* at home." If you build it, they will hum.

—Steve Hamm



AT THE CAR WASH

MR. CLEAN, Procter & Gamble's iconic floor cleaner, strode out to the driveway in 2004 when P&G launched Mr. Clean AutoDry, a car cleaning system that attaches to a hose. Now the bald muscleman will rule over a car wash P&G will open this spring near its Cincinnati headquarters. **P&G says it's testing an opportunity it sees for a more upscale autowash: This one will include a café, widescreen TVs, a gift shop, and a soap gun kids can shoot at cars going through the line.** The facility, which won't use AutoDry (it will be sold in the gift shop, along with Swiffer dusters), is also envisioned as a lab for observing consumers and developing product ideas. —Robert Bern

BLOGSPOTTING CAREER ANGST

<http://blog.penelopetrunk.com/>

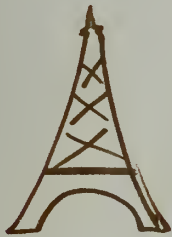
»**Anguished** twenty-somethings contemplating various career options should check out Brazen Careerist for syndicated columnist Penelope Trunk's take on the "quarterlife crisis" (a condition affecting stalled college grads that usually involves "takeout pizza" and "obsessive" instant messaging, according to Trunk). This humorous blog also tackles such universal dilemmas as how to politely turn down a job offer and how to properly manage one's appearance, including an amusing account of Trunk's own misadventure hiring a personal stylist.

—Lindsay Gerdes



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DEATH BENEFITS

ORGAN DONOR ECONOMICS

WITH TRANSPLANTABLE hearts, lungs, livers, and kidneys in short supply, the federal government says about 7,000 people die annually while awaiting donor organs.

Now two economics professors, David Harrington of Kenyon College and Edward Sayre of Agnes Scott College, have come up with an economic theory to explain the organ shortage.

In their view, the problem begins with cadavers donated to medical schools. Laws have long been on the books allowing the schools to compensate families of donors. Typically, the med school covers the cost of cremation after a cadaver has served its purpose. That's roughly a \$1,000 benefit for the donor's survivors.

But a 1984 law, the



NEEDED
Thousands die waiting for organs

National Organ Transplant Act, prohibits any similar incentives for donating the organs of individuals at the time of death. The result, Harrington and Sayre say, is that there is a financial motive to bestow a whole body. And med schools won't take cadavers if organs have been harvested from them.

The cremation benefit really has an impact, the economists say. In an article appearing in the winter issue of *Regulation*, a Cato

Institute publication, they show statistically that all else being equal, people are more likely to donate their bodies to medical schools in states where cremations are more expensive. Their next task is to check whether organ donations are lower in those states. Meanwhile, they note, medical schools in the U.S. have a surplus of cadavers. Tulane University School of Medicine, for example, consistently gets more cadavers than it needs.

(It reroutes some to other medical schools.) Some schools have even had employees illegally selling surplus body parts to "body brokers."

Harrington and Sayre argue that allowing organ donors to get the same compensation as whole-body donors would help stave off such illegal trafficking and create an ample supply of transplantable organs to save the lives of the critically ill.

The National Kidney Foundation has opposed any kind of compensation to families of donors, calling it dangerously close to the frightening practice of paying living people for their organs. But Harrington and Sayre argue that increasing the supply of organs from newly deceased would satisfy most of the demand and thus actually dry up the illicit trade in organs—mainly kidneys—from living people. Says Harrington: "We're suggesting that market incentives are a pragmatic response to a pressing problem." —Peter Coy

QUESTION OF THE WEEK

If you were to ask Congress to make one important fix on immigration, what would it be?

—Eva Rodriguez

"I'd ask for a comprehensive solution—an earned path to citizenship, expanded visas to reunite families, secure borders, and vigorous labor and civil rights protections for all workers."

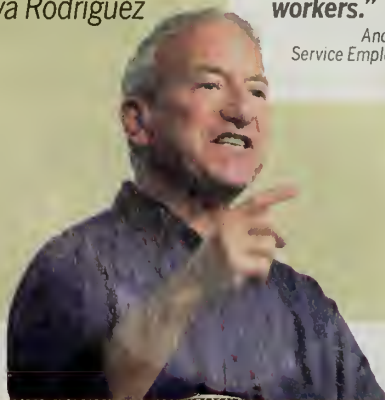
Andy Stern, president, Service Employees International Union (SEIU)

"I think Congress should be forced to consider the impact—environmental impact, cost impact—before passing legislation that could add more than one hundred million people in the next five decades."

Nancy S. Anthony, president, Fernwood Advisors; chairman, Federation for American Immigration Reform

"A guest worker program, protection for employers who play by the rules, and better ways to help employers screen out unauthorized workers. This might protect law-abiding companies from government raids."

Sam Rovit, president and CEO, Swift & Co.





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I could write a book about the decline in service, knowledge, and morale of [Home Depot's] employees."

—William Yantorno
 Danbury, Conn.



NARDELLI'S LEGACY: A LESSON ABOUT PAY AND PERFORMANCE

THE REAL LESSON in "Out at Home Depot" (Cover Story, Jan. 15) may be that GE executives are extremely well-trained in hitting operational targets but know little or nothing about picking the targets that will produce shareholder value.

The financial indicators highlighted in your article did not turn down until 2006, but the stock market seemed to sense the problem much earlier. How? Despite the sales growth and rising gross margins, the important measure, free cash flow, has been virtually flat since 2001. For the analysts, Home Depot Inc. was not performing.

Robert L. Nardelli's insistence that he not have his compensation tied to the stock price was his most successful negotiating move. It might also have been the best indicator that he did not understand anything about what stockholders wanted.

—Shepherd G. Pryor IV
 Highland Park, Ill.

WHO IN THEIR right mind would hire a CEO to run an \$82 billion, publicly traded corporation without tying his compensation to some sort of performance measure? In a sense, I do not blame Nardelli

for sticking to his guns in regard to compensation; the board has nobody blame but themselves.

While Nardelli was apparently a poor CEO, he did say something that was true: "Share price is the one measure of company performance that [he] can control." It's no wonder that many CEOs and companies are "going private" so they can run their companies and create long-term value without being held hostage by an institution that prides itself on shortsightedness, namely Wall Street.

—Christopher Sie
 Pompano Beach, Fla.

I'VE BEEN A part-time Home Depot employee for over 10 years, and I could write a book about the decline in service, knowledge, and morale of its employees.

Nardelli made an enormous amount of money at the expense of the company. For example, he did away with the \$25 gift card each employee received before the holidays. Now we get a coupon worth 20% off a future purchase. He did away with the longevity pay experienced employees receive every five years. He did away with hands-

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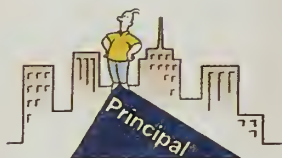


THE SINGLE MALT THAT STARTED IT ALL.

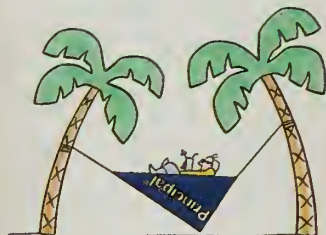
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training. I can't think of one change he made that helped the employees.

—William Yantorno
Danbury, Conn.

DON'T CUT STEVE JOBS ANY SLACK ON OPTIONS BACKDATING

THE IMPLICATION IN "Is Steve Jobs untouchable?" (News & Insights, Jan. 15) that it is acceptable to be a CEO and a recipient of backdated options if you didn't understand the accounting or if the stock has done well and shareholders have not been disadvantaged, totally misses the point. The options were granted under his watch, and he as CEO is accountable.

—David T. Fronek
Indianapolis

PETER BURROWS' PAEAN to Steve Jobs contains the most tortuous rationalizations on an appropriate response to options backdating that I've encountered. My own premise is, simply, that a thief is someone who takes something that does not belong to him and that he is not entitled to.

As for the notion that Jobs is a "national treasure," please. He is a forward-thinking innovator who runs a company that makes gadgets. Mount Rushmore isn't ready for a fifth face.

—Jane Brannon
Naperville, Ill.

HUMANE FARMERS ALREADY HAVE A BADGE OF HONOR

"A SEAL OF APPROVAL for the milk of human kindness" (Up Front, Jan. 15) did not include the "Certified Humane Raised and Handled" food label, administered by Virginia-based Humane Farm Animal Care.

We believe this is the gold standard of such labels, because producers who have earned the right to use it are certified to have humanely treated their animals at every stage in the food production process.

—Ed Sayres, President
The American Society for the Prevention of Cruelty to Animals
New York

IF BIG PHARMA GETS ITS WAY, SOME CONSUMERS WILL SUFFER

"IS YOUR MEDICINE the real deal" (Science & Technology, Jan. 8) does not present a complete picture of pharmacy compounding, a vital medical service.

Improving patient health is a pharmacist's top priority and the vast majority adheres to high standards of quality. When a pharmacy breaks the law, state boards of pharmacy step in. Fortunately, such behavior is rare. Unfortunately, though,

pharmaceutical manufacturers are limited incidents to justify sweeping regulations that would harm patients.

By driving the Food & Drug Administration to make it difficult, if not impossible, for doctors to prescribe compounded medicines, manufacturers would force patients to take their proprietary one-size-fits-all products. Patients' unique health needs would be shut out.

—L.D. ...
Executive Director
Association of Compounding Pharmacists
Sugar Land, Texas

ONLY MONEY MOTIVATES THE MAKERS OF HERBAL REMEDIES

I FIND STEVE MISTER's letter (Readers Report, Jan. 29) in rebuttal to the review of *Natural Causes*, "Modern soil?" (Books, Jan. 8), appalling. The calling the kettle black? "Science is usually absent in *Natural Causes*," writes Mister, president and CEO of the herbal supplement industry trade group Council for Responsible Nutrition. That is exactly the case with the very existence of "herbal remedies." That the safety record is the result of conscientious producers and manufacturers would be laughable if it were not so glaringly false.

Manufacturers of herbal supplements are interested in just one thing: profit. The "Council for Responsible Nutrition" is about as aptly named as "Intelligent Design," words cleverly chosen to be misleading.

That 150 million ill-informed Americans get sucked in each year does not prove Mister's case. It simply points to the power of misleading advertising claims.

—Bruce W. Parkinson
San Jose, Calif.

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*Top-tier ranking for managers of lifecycle funds (No. 4 in the nation as measured by lifecycle mutual fund assets under management as of Sept. 30, 2006 - Source: Financial Research Corporation). ©2007 Principal Financial Services, Inc. "The Principal," "Principal Financial Group" and the Edge design are registered service marks, and the illustrated character and "We'll Give You an Edge" are service marks of Principal Financial Services, Inc. \$53 billion AUM for Principal Funds and WM Group of Funds as of 11/30/06. Principal Investors Fund, Inc. is distributed by Principal Funds Distributor, Inc., member of the Principal Financial Group® Principal Funds Distributor, Principal Shareholder Services, Principal Management Corporation and Principal Investors Fund, Inc. are collectively referred to as Principal Funds. #7874122008



Juicing Up Home Networks

In the home of the not-too-distant future, video will zip from room to room. You'll be watching movies downloaded from the Internet in your bedroom and cable TV on your PC. Of course, the high-speed network needed to make this latest vision of the "connected home" function doesn't quite exist yet—but it may be hiding in your walls.

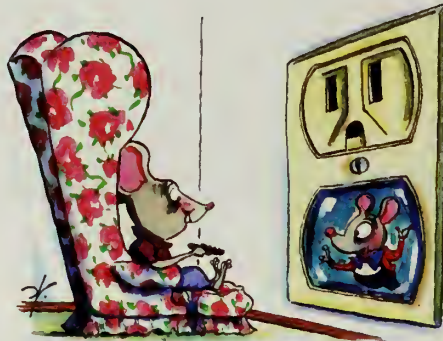
The simplest way to move data quickly is through the modified phone wiring known as Cat5 cable, the standard Ethernet network cable. The problem is that few homes, even new ones, are wired, and while Cat5 cable costs little to install in new construction, it is expensive to pull through existing walls.

Most people get around the lack of cables using wireless. But the current generation of Wi-Fi is not fast enough to deliver quality video reliably. A new version, called 802.11n, is starting to appear, and Apple is counting on it to deliver video from iTunes on PCs to TVs via its Apple TV adapter. I'll be testing Apple TV when it's available, but I'm frankly dubious about the wireless part. There are just too many things in a home, from microwave ovens to people moving about, that can create interference and spoil the viewing experience.

A GOOD ALTERNATIVE MAY EXIST in the power wiring that already runs through your house. The idea of carrying data over electrical wires has been around for a long time, but early versions were slow and prone to interference, especially the electrical noise generated when appliance or air-conditioning motors start up. A new generation of powerline networking not only overcomes these difficulties but offers speeds at least as fast as the newest Wi-Fi. And the latest products are not subject to the seemingly random fluctuations in performance that afflict wireless.

I tested three different systems. A prototype from ZyXEL Communications uses a new standard called HomePlug AV. The others, the NetGear HDX101 (about \$170 for the two units you'll need) and the Panasonic HD-PLC (about \$200 a pair), use a rival approach called Powerline HD.

Setting up powerline networking is simplicity itself. You plug an adapter into a power outlet and connect it to any port in your router with a standard Ethernet cable. Then you plug in additional adapters in any room where you need network service and connect a PC with another cable. As long as the hidden wires feeding the outlets are connected to each other somewhere, usually at the circuit



The wiring behind your walls could connect the video in all your rooms

breaker box, networking should work.

Both flavors of powerline network claim speeds of up to 200 megabits per second, but as is the case with all networking technologies, you can only expect to see a small fraction of that theoretical maximum when moving data. With the powerline products, I saw average speeds of 12 to 20 megabits per second when moving large files between PCs. That's a bit faster than what I recorded on a Wi-Fi network with a rated speed of 54 megabits per second

but only about half the speed I got using cabled Ethernet.

The problem with video is that the average speed doesn't tell you much. A brief interruption would really affect the average speed, but it will likely cause the picture to freeze temporarily and may also produce a hiccup in sound. I found that the powerline system did a fine job of delivering broadcast-quality TV and could handle DVD quality with only

an occasional glitch. High-definition TV was rougher: The picture froze repeatedly, and the sound started and stopped. For HD, we may have to wait for an approach called MoCA (for the sponsoring Multimedia over Coax Alliance), which sends data over the wires used by cable TV.

Powerline networking is more expensive and less convenient than Wi-Fi. But it can deliver data faster and more reliably than wireless. It may be what's required to take us to the next stage of networked entertainment. ■

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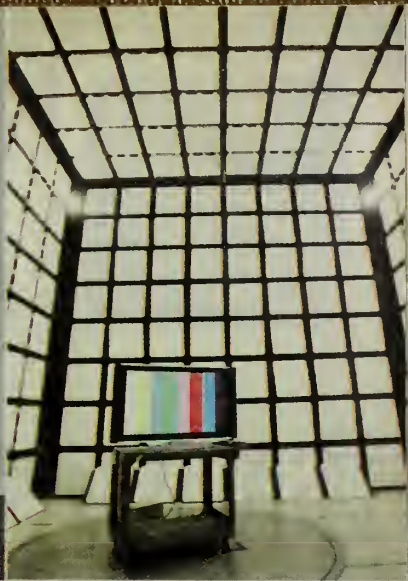
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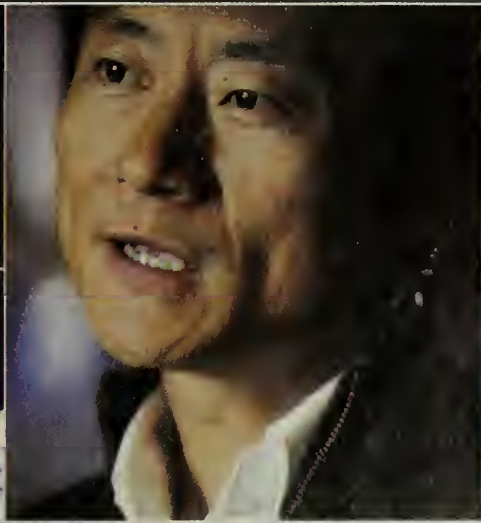
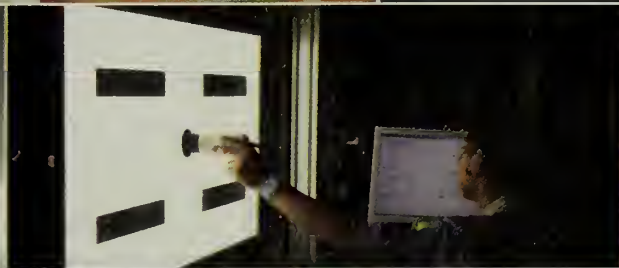
The True Story of the
People Behind Plasma



No matter where in the world they're made, Hitachi plasma TVs have one trait in common: They're the product of *kaizen*, the Japanese concept of continuous improvement — a concept that guides the efforts of every Hitachi employee.

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Say Hello to the Alpha Kitty

In certain mediacentric precincts of Manhattan and Los Angeles, a striking and charismatic young woman named Atoosa Rubenstein moves from handshake to handshake, from meeting with advisers to pitching potential financial backers. In this, Rubenstein resembles a Presidential candidate testing the waters in Iowa. But her campaign is to build the next

big multimedia brand around a person. This person happens to be named Atoosa Rubenstein.

She is about to find out if her status within an insular sphere—as a star magazine editor with fashion cred—and more than 43,000 friends on MySpace.com can propel her to something much grander. For this ill-defined opportunity, centering initially on the unbuilt Web site *atoosa.com*, Rubenstein last year dumped her job as editor-in-chief of *Seventeen*. “I saw what was coming,” she said, referring to the ongoing Web-driven destruction of the teen magazine. “What I want to do is gather my tribe”—yes, Rubenstein actually says things like this—“the ones reading *Seventeen*, and the ones who were, and grew out of it.” This tribe is 13 to 30, female, thoroughly digital, and, in Rubenstein’s view, lacking an “alpha kitty” addressing their concerns and sensibility. What she brings is her big-sister, geek-gone-glam persona. She honed this act editing *Seventeen* and teen title *CosmoGIRL*, and now shows it in full plumage in her MySpace blog entries, which are a riot of excessive capitalization and estrogenic display. The ultimate shape of Atoosa Inc. is inchoate, but Rubenstein is certain of one thing. “The next Oprah will not be born on TV,” she says. “I left to launch my brand.”

SHE ALREADY HAS, OF COURSE. Rubenstein’s got the high-wattage personality and presence that gets noticed, and she possesses ambition that’s impossible to miss. It is not just anyone who gets named editor-in-chief of a major magazine at 26, which is how old Rubenstein was in 1998 when she started *CosmoGIRL*. “You thought, ‘she had to do it,’” says Hearst Magazines President Cathleen Black, recalling the first meeting in which Rubenstein described that

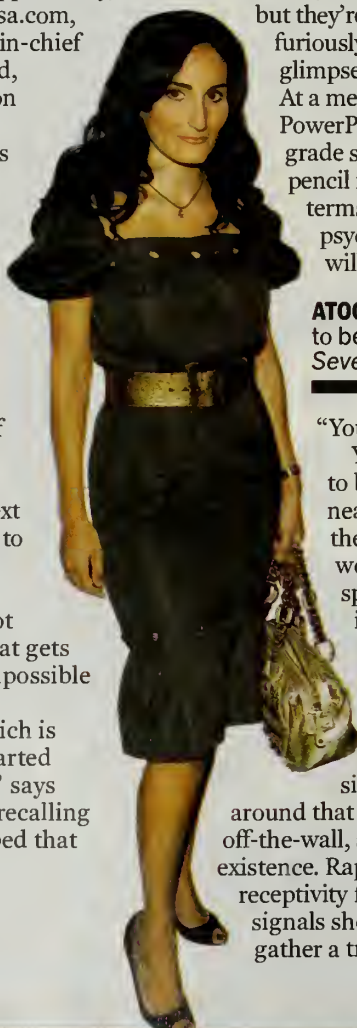
magazine. “It was seeping out of her pores.”

These days Rubenstein’s parent company is her own Big Momma Productions, which explains the enormous ring that emblazons “BIG MOMMA” across three fingers, (a gift from her husband, she explains). In a meeting, she says about her audience, without apparent irony: “They are unborn to me but they’re mine.” Still, her sense of ownership and her furiously fashionista exterior is often punctured by glimpses of the homespun and deeply idiosyncratic. At a meeting with potential investors she skips PowerPoint in favor of construction paper decorated, grade school project-style, with a crazy-quilt of color pencil notations. Her first offering may be what she terms her “art project,” *Psychic Kitty*, a series of psychedelized videos on her MySpace page. They will star her cat Thurston spouting, in Rubenstein’s electronically processed voice, brief inspirational tidbits. Rubenstein calls *Psychic Kitty* “the cat in the family,” and she’s mum on a debut date.

ATOOSA: Aiming to be Oprah to her *Seventeen* tribe

“You know how it is with cats.”

You may, like me, find *Psychic Kitty* so bent as to be half-brilliant. But what I find conceptually neat isn’t relevant; the question is how weird the mainstream is willing to get. Of course, well-conceived media brands that assuage the spiritual thirst of American women have an impressive track record. (Ask Oprah.) “I have a dream,” says Rubenstein. “I see a family. I see a tribe. At the end of the day, I know how to connect with this audience.” Rubenstein says her brand attributes—again, she really does this—are inspiration and motivation, sisterhood, positivity, and activism. Wreathed around that is a certain Atoosa-ness: an ease with the off-the-wall, an acceptance of the mess and dorkiness of existence. Rapt comments on her blog suggest at least some receptivity for this message. We will soon see if the smol signals she’s sending out, in all her inimitable style, can gather a tribe big enough to make a business. ■



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BY JAMES C. COOPER

A Stronger Economy? Yes. Higher Inflation? No

The rules have changed. Business is focused on cost control, not prices

U.S. ECONOMY Ask investors, especially those in the bond market, where they think inflation is headed in 2007, and they will most likely say down. They are probably right, but maybe not for the reasons they think. Many expect the economy to be weak enough to allow core inflation, which excludes prices for energy and food, to fall.

The twist is that the economy is already proving stronger than anticipated, but despite that vigor, inflation may still decline anyway.

There is still a sense in the markets that a strong economy means higher inflation, and a weak economy means lower inflation. But over the past decade, the growth/inflation relationship has become a lot fuzzier, because the processes that influence inflation have changed drastically. A lot of market folks still haven't caught on, which can lead to misguided expectations about Federal Reserve policy and interest rates.

To begin with, the Fed has built enormous credibility as an inflation fighter, and central banks around the world have placed a new emphasis on inflation control. These efforts have held down expectations of future inflation among both businesses and consumers. With expectations more firmly anchored, it's harder for inflation to spiral upward as an economy strengthens. The overarching change, however, is the way globalization and technology have altered corporate pricing behavior in the face of rising costs. The resulting ensification of competitive forces limits the ability of companies to simply mark up prices based on cost increases. It has made cost control, rather than pricing power, the driving force behind corporate profit margins and earnings growth. Late in a business cycle, as now, when cost pressures from labor and other resources begin to rise, businesses have to bolster their profits by cutting costs, not by raising prices. Those that fail to do so see their margins squeezed.

ISING COST PRESSURES of late, especially from tighter labor markets, are already beginning to send caution flags in some corners of Wall Street. Some analysts note that last year's economic slowdown did nothing to vent the steam in the labor market: In fact, the employment rate continued to decline. Now reports indicate that the economy is picking up again, suggesting labor markets may tighten even further this year. In the past, labor costs have been a central factor pushing companies to lift prices, but this time the pressures may not be as intense. For example, although

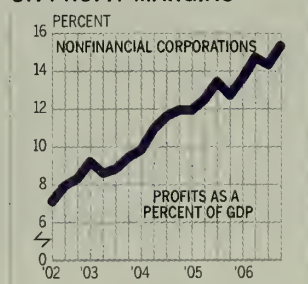
job markets were tightening last year at the same time energy costs were soaring, pricing power made only limited gains. Still, profit margins widened to record levels, and earnings kept beating expectations (chart). The latest industry survey by the National Association for Business Economics shows margins continued to make steady improvement heading into 2007. This pattern is hardly a sign of burdensome costs, and it suggests the labor market may have room to tighten further in 2007 without putting severe pressure on costs or prices.

ONE AREA WHERE cost control in the labor market is vividly apparent is corporate benefits, particularly for health care. As businesses have shifted much more of that burden to workers, expenses for all benefits, about 30% of corporate labor costs, have slowed sharply. Two

years ago, benefits were growing 7.2% per year, according to the Labor Dept. As of the third quarter of 2006, benefits were up only 2.9% from the year before.

Another major change lowering costs is the proliferation of performance-based pay, compensation that is directly linked either to productivity or to a

NO SIGN OF PRESSURE ON PROFIT MARGINS



Data: Bureau of Economic Analysis, Global Insight Inc.

company's profits. Paying a worker for more productivity doesn't lift the labor cost per unit, so price and profit margin are not affected. The same is true for pay linked to profits, such as bonuses or stock options, two practices that have worked their way down the job ranks and boosted recent readings on labor income.

Technology is another factor. It's not just that businesses have new tools to lift productivity and cut costs. Also important, the Internet has cut into the information advantage sellers used to hold over buyers. Given a greater flow of information on products and their costs, buyers have more power in the marketplace, a shift

that has added another layer of competitive pressure on businesses to restrain their costs and prices.

One of the biggest problems in assessing the inflation outlook is knowing which measure of labor cost tells the true story. Right now, the most worrisome-looking gauges are the least credible. Take the gains in average hourly pay for production workers, which have accelerated from 2.5% in 2004 to 3.2% in 2005, and to 4.2% in 2006.

But that measure is not adjusted for the changing mix of jobs surveyed, which in recent years has favored higher-paying industries, such as business services and health care, thus lifting the average. The Labor Dept.'s employment cost index, a more comprehensive measure of hourly wages, is not affected by changes in composition. It shows annual growth of only 2.5% in 2004 and 3.1% through the third quarter of 2006.

Another case is unit labor costs, or compensation adjusted for productivity. The Labor Dept. offers two versions: one for the nonfarm business sector and one for the nonfinancial corporate sector. The former shows unit costs through the third quarter up 2.9% from the year before, while the latter has risen only 0.5%. Many economists, even some at the Fed, believe the tamer-looking cost measures are closer to the truth.

FINALLY, THE MAIN INFLATION GAUGE, the consumer price index, needs to be interpreted with care. Fed officials believe the CPI overstates the true rate of inflation. That's why they concentrate on the price index for personal consumption expenditures, minus energy and food. Last year, the core CPI rose 2.6%, while the

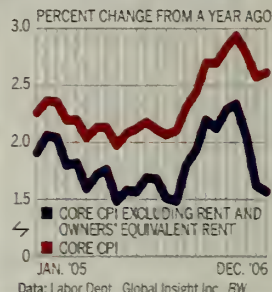
Fed's preferred gauge was up only 2.2% as of November.

The behavior of housing costs in the CPI will also add a downward tilt to core inflation in 2007, after pushing it up in 2006. The cost of homeownership in the CPI is based on what a home would bring on the rental market. Last year, soaring home prices made renting more

attractive, pushing up the demand for rental units, and with it, rents. This imputed cost, which is 30% of the core CPI, accelerated sharply last year and more than accounted for the speedup in core inflation.

This effect will reverse in 2007, pushing core inflation down. Rents will fall as more affordable home prices lift home-

MINUS HOUSING COSTS, INFLATION LOOKS TAME



demand and unsold condominiums languishing on the market are converted to rentals. Excluding rents and rent-based housing costs, annual core inflation is already falling, ending 2006 at only 1.6% (chart).

The bottom line: An economy that ends up stronger than the markets now expect would kill investors' hopes for Fed rate cuts this year. But it would not automatically imply higher inflation that would force the Fed to hike rates. The result might well be a year of solid growth, low inflation, and stable interest rates. That's a scenario an investor would welcome. ■

SEASONAL TRENDS

It's Not Just Weather Heating Up the Data

FROM HIRING to retail sales to manufacturing output, most of December's economic data were surprisingly strong. Weather would seem to be a logical cause, given that it was the fourth-warmest December in the U.S. since 1895.

But an historical look at temperatures and various economic indicators by economists at JPMorgan Chase shows that unseasonably warm temperatures in the winter provide little pop to economic growth. Construction is the only sector that is meaningfully affected by colder weather. The warm December temperatures likely raised the seasonally adjusted number of

housing starts by about 43,000 at an annualized rate and held the drop in construction payrolls to 3,000, vs. 21,000 had temperatures been more normal, according to JPMorgan.

The economic boost from warmer temperatures is bigger in January than it is in December, but the impact is still rather limited. Because the government conducted its January

employment survey while temperatures were still mild, JPMorgan economist Haseeb Ahmed expects construction payrolls to be 50,000 higher than they otherwise would be, a result of fewer seasonal layoffs.

Rather than reflecting warmer temperatures,

the December numbers most likely indicate better economic fundamentals heading into the new year. Ahmed believes that the stronger economic performance is largely attributable to a healthy job market and lower energy prices, which are allowing consumers to keep spending.

Indeed, the weather may provide a lasting benefit through the winter because it has lowered demand for energy products. "Reduced energy consumption for heating purposes has contributed to abnormally large stockpiles—and declining prices—for propane, natural gas, and home heating oil," says Richard DeKaser, chief economist at National City Co.

If temperatures remain normal, ample energy inventories should continue to restrain prices and allow the economy to keep its momentum.

—By James Mehring in New York

A WARM DECEMBER

	AVERAGE DECEMBER TEMPERATURE	DEGREES ABOVE HISTORICAL AVERAGES
U.S.	37.1 °F	3.7 °F
NORTHEAST	34.9	8.2
SOUTHEAST	51.9	4.5
CENTRAL	39.1	5.7
EAST NORTH CENTRAL	28.8	9.3

Data: National Climatic Data Center

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The Business Week

News you need to know

EDITED BY HARRY MAURER



State of the Union His ratings are scraping the floor. The Democrats have grabbed control of Congress. And he spent much of his Jan. 23 State of the Union address defending the unpopular war in Iraq. But **President George W. Bush** (photo, with **Vice-President Dick Cheney** and **House Speaker Nancy Pelosi**) still mounted a hard sell on an agenda that will affect business, including reducing American consumption of gasoline by 20% over 10 years.

Bush broke new ground by proposing higher fuel economy standards for cars. He called for a sharp jump in the supply of renewable and alternative fuels. And he highlighted a health-care plan that would offer new tax deductions for insurance costs but for the first time treat employer contributions to health benefit plans as taxable income. While many proposals met with skepticism, his commitment to a comprehensive immigration bill garnered long applause from both parties.

ONLINE See "Salesman in chief," www.businessweek.com/go/tbw

More Pain at Pfizer "Fundamental change is imperative." So said new **Pfizer CEO Jeffrey Kindler** on Jan. 23, describing a leaner company that will require 7,800 layoffs on top of the 2,200 announced in December. Another troubled company, **Motorola**, chopped 3,500 jobs on Jan. 19.

See "The doctor won't see you now," page 30

ONLINE "Pfizer swallows the medicine," www.businessweek.com/go/tbw

Reining in K Street Newly empowered Democrats and reform-minded Republicans are spraying disinfectant around Congress. On Jan. 18 the Senate passed an ethics bill that tightens regulations on some of the practices that featured in the **Jack Abramoff** lobbying scandal. Among other changes, the bill bars gifts to senators from lobbyists, forces senators to pay full price for sports tickets and corporate jet travel, and largely ends congressional travel paid for by Corporate America. The House has already enacted similar reforms as rules changes.

Unlikely Teammates For once, bitter rivals **Morgan Stanley** and **Goldman Sachs** are lining up on the same side of the scrimmage line. A source close to the deal said on Jan. 24 that they're part of a bidding group, along with private equity heavies, hunting the oil and gas production assets of **Dominion Resources**, a utility based in Richmond, Va. Analyst **Daniele Seitz** of **Dahlman Rose** figures the price could go as high as \$18 billion. That would make it the biggest private equity energy play ever.

Shakeup at Citi Apparently running out of patience with the unit's sky-high expenses, **Citigroup CEO Charles "Chuck" Prince** on Jan. 23 fired wealth management chief **Todd Thorson** and replaced him with **CFO Sallie Krawcheck**. Prince was looking for a new CFO. The move was viewed on Wall Street as a demotion for ex-golden girl Krawcheck, who has held the wealth management post before.

See "At Citi, more heat on Chuck Prince," page 30

Broadcom Points a Finger Apple did its best to clear co-founder **Steve Jobs** of stock option backdating blame. Now so at chipmaker **Broadcom**. The company's audit committee said in an SEC filing on Jan. 23 that founder and former **CEO Henry Nichols III** "bears significant responsibility for the lack of adequate controls...due to the tone and style of the ongoing business he set." The company added \$2.24 billion in expenses because of alleged backdating from 1998 through 2003. Nichols' lawyer says Nichols didn't benefit from the backdating and sought advice from professionals.

Telecom Trouble New telecom equipment giant **Alcatel-Lucent** acknowledged on Jan. 23 that it would badly miss 2006 sales and earnings targets, and shares sagged by as much as 12%. The company said profits would fall 26%, to \$1.3 billion, with sales flat at \$24 billion. **CEO Patricia Russo** said fourth-quarter revenues tanked as customers delay placing orders because of merger uncertainty. But analysts noted more alarming trends: The Paris company is losing share to wireless equipment rivals such as **Ericsson** and **Huawei**. Its once-dominant broadband and fiber-optics units are looking vulnerable, too.

ONLINE See "The reasons for Alcatel's 'shocking' miss," www.businessweek.com/go/tbw

Another Quick Exit On Jan. 22, after all of four months in the job, **Sears CFO Craig T. Monaghan** stepped down for the

er-popular "family reasons." He joined a growing number of short-timers with departures announced in the past 10 months. They include: **Michael Wolf**, COO of MTV Networks (14 months), **Wal-Mart** marketing executive **Julie Roehm** (10 months), and **J.C. Penney COO Catherine West** (6 months). The slew of fast flameouts may be a fluke, but there's no denying that heightened competition, increasingly vigilant investors, and demanding consumers have left stressed-out CEOs quick to pull the trigger.

Tribune's Tribulations The latest billionaire to enter the bidding for **Tribune Co.**: **Rupert Murdoch**. The **News Corp.** magnate is joining Los Angeles' **Chandler** family in making an offer for the Chicago-based media giant, a source close to the deal said on Jan. 24. The plan involves combining the operations of Murdoch's **New York Post** with Tribune's **New York Newsday**. Los Angeles moguls **Eli Broad** and **Ron Perle** have also made overtures, putting \$500 million down. A third bid from buyout firm **Carlyle Group** involves buying Tribune's stations. The board is mulling; a decision is expected by the end of March.

\$10 Billion and a Dream Feeling lucky? Then **Illinois** Governor **Rod Blagojevich** has the deal for you. The recently elected Democrat has given private investors until Feb. 15 to submit bids to buy the state lottery. Begun in 1974, the lottery generates some \$650 million a year, which the state spends on education. But by privatizing, Illinois could hit the jackpot: Blagojevich figures the sale could raise \$10 billion. He seems to be taking a nod from **Chicago Mayor Richard Daley**, who has sold off a series of city assets, including a 7.8-mile tollway for \$1.83 billion in late 2004. Other states are considering similar measures, including **Indiana**, which may unload its lottery, too.

Ouster of the Week

Ultimately, he just didn't fit. On Jan. 22, **Gap**, operator of the **Gap**, **Old Navy**, and **Banana Republic** chains, said **CEO Paul Pressler** and the board "mutually agreed" that he would bow out after a tumultuous four years. A veteran cost-cutter who ran **Walt Disney's** theme parks, Pressler from the start acknowledged that he was a fashion neophyte. He threw himself into sprucing up Gap's balance sheet and putting the brakes on store expansion. But the creative side of the business didn't fare so well, resulting in merchandise and marketing that fizzled and declining performance that included dismal sales during the recent holiday season.

PAUL PRESSLER

Gap's board says it's shopping for a successor "who has deep retailing and merchandising experience, ideally in apparel" and who "understands the creative process."

See "Seismic change at Gap?" page 98

ONLINE "CEO wanted: Gap's search for a savior," www.businessweek.com/go/tbw

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BIG PHARMA

THE DOCTOR WON'T SEE YOU NOW

At Pfizer, the loss of thousands of jobs signals the end of the hard-sell era when armies of drug salespeople stormed doctors' offices. **BY ARLENE WEINTRAUB**

DR. LUCY E. HORNSTEIN IS fed up with pharmaceutical salespeople. So whenever a rep walks into her Valley Forge (Pa.) family practice, she whips out a sheet of rules. Among them: No visits allowed except between noon and 2 p.m. Do not bring any pens, sticky pads, or other knickknacks bearing the name of the drug you're touting. Furthermore, Hornstein says, "I tell them, 'don't talk to me about drugs because everything you say is propaganda.'" The constant stream of salespeople in Hornstein's office has pretty much dried up, for which she declares: "Good riddance."

Bye-bye Big Pharma sales rep. A host of forces is now converging to clamp down on hard-driving, gift-toting pharmaceutical pitchmasters who have been ambushing physicians for the last decade. Doctors, consumer groups, and government regulators have all had enough. And now, pharma CEOs are questioning whether the hard sell even pays off. On Jan. 22, Pfizer Inc. announced unprecedented layoffs. As part of an effort to cut

\$2 billion in costs by the end of 2008, and to adjust to the loss of patents on several blockbusters, it plans to eliminate 7,800 jobs across the board, including 20% of the European sales force. That's on top of the 2,200 U.S. salespeople who were let go in November.

Because Pfizer will no longer be assigning armies of reps to each of its products, other Big Pharma companies may feel free to follow suit. "It's a watershed event for the industry," says Michael J. Luby, a former Merck & Co. marketing exec who is now CEO of TargetRx Inc., a drug industry consulting firm in

Horsham, Pa. "In every boardroom, must be considering this."

DAMAGED REPUTATIONS

TOP EXECUTIVES at the drug companies understand that the shift will be beneficial: It will force them to find new, more effective sales strategies that ultimately boost the bottom line. "What we really aspire to is a culture of productivity and continuous improvement," Pfizer CEO Jeffrey B. Kindler told analysts on Jan. 22. "Every employee will be looking for ways of doing things more efficiently."

The changes (table, page 32) could also help repair the drug industry's damaged reputation. In a survey released on Jan. 9 by PricewaterhouseCoopers, 94% of physicians, hospital execs, and other health care stakeholders said they thought drug companies spend too much money promoting their products. And 94% of consumers said they thought companies can be too aggressive in promoting unapproved, "off-label" uses of their products—an ill-timed tactic. It's not just that pharma

THE STAT

100,000

Big Pharma's vast U.S. sales force today. It could shrink as much as 20% in the next three years.

Data: Hay Group Inc.



companies have been known to deploy as many as a half-dozen reps to hit the same doctor for the same product. The industry also spends \$4 billion each year beaming their messages directly into consumers' homes. "Clearly, the public thinks the drug industry's focus is on increasing prescriptions rather than improving patients' health," says Peter Claude, a partner in Pricewaterhouse's pharmaceutical practice. "That's a turnoff."

Consider the profile of the typical pharma sales rep. He or she is often recruited straight out of college, lured by lush compensation and a company car. Top recruits are prized not so much for their scientific prowess—science degrees are rarely required—but for their movie-star looks, charisma, and talent in cheerleading new products. Armed with outsize expense accounts, they often shower physicians with free meals, golf outings, and other perks. "It was small-time bribery," says former Pfizer and Eli Lilly & Co. sales rep Jamie Reidy, who wrote *Hard Sell: The Evolution of a Viagra Salesman* and has sold the movie rights to Universal Pictures. A Pfizer spokesman replies: "We have developed rigorous compliance programs to promote appropriate interactions with the medical community."

WARY OF PITCHES

EVEN THOUGH COMPANIES are being more careful, many hospitals have banned pharmaceutical giveaways, and a handful have banished reps altogether. Those who can get in the door often wait an hour for a mere 90 seconds with the doctor, says Bob Davenport, vice-president of Hay Group Inc., a consulting company in Philadelphia. "The only reason a lot of doctors still see reps is to get the free drug samples," he says. Further eroding the public's sense of trust are frequent government investiga-

tions into off-label marketing by drug companies.

Medical schools are grumbling, too. Over 25 teaching institutions are developing programs that train students to be skeptical of Big Pharma pitches. New York's Mount Sinai School of Medicine is designing simulation exercises that will let students spar with actors playing salespeople, to build "skills to evaluate drug-company claims," says Dr. Ethan A. Halm, associate professor of medicine and health policy. The effort is being funded by Pfizer as part of the \$430 million it paid in 2004 to settle charges that a company it acquired illegally promoted a drug for off-label uses.

Big Pharma companies are learning that storming doctors' offices with multiple overlapping salespeople is woefully inefficient. Fewer than 25% of visits to physicians result in actual face time, says investment bank Leerink Swann & Co. in a Jan. 3 report. That's a lot of wasted effort for folks who typically cost their employers \$200,000 per year. Other companies that could benefit from sales-force cuts include GlaxoSmithKline PLC and Sanofi-Aventis, say Leerink analysts. Lehman Brothers Inc. adds Schering-Plough Corp. to that list and predicts that a 20% reduction in sales expenses across the industry would lift large-cap pharma earnings by 3%. Spokespeople for those companies say they have no current plans for cuts.

Pharmaceutical companies that have already shrunk their sales forces are finding innovative ways to do more with less. Bristol-Myers Squibb Co., which has cut 1,300



"What we really aspire to is a culture of productivity."

Pfizer CEO JEFFREY KINDLER

salespeople since 2000, tracks physicians' prescribing patterns and adjusts its promotional activity accordingly. A full 18 months before its cholesterol-lowering drug Pravachol lost its off-invented protection last April, the company halved the calls dedicated to the drug and instructed reps to focus on call on doctors who were already prescribing it. "We figured those who had prescribed it yet weren't going to start now," says Jeffrey Hooper, Bristol's president of U.S. pharmaceutical sales. Despite the changes, prescription rates didn't fall. Between 2000 and 2002, overall productivity per rep jumped more than 4%, Bristol says.

Some companies, including Bristol and Merck,

are supplementing often brief physician visits with "e-detailing." They may, for example, point doctors to interactive Web sites that teach them about new drugs and that can be updated instantly with fresh clinical-trial data to support their sales pitches.

Pfizer executives say they're evaluating a number of new approaches to boost the efficiency of their now smaller sales force. "I do believe that over a period of years, this industry will find better ways to leverage its resources and improve interactions with physicians," says Reed, president of worldwide pharmaceutical operations. "We'll see an evolution. These days, no more than two Pfizer sales reps are assigned to any one physician to pitch the same product. And no one is going to miss the sticky pads and pens."

Hard Times for the Hard Sell

Big Pharma is moving away from aggressive sales tactics.

WHAT HAS CHANGED?

DOCTORS ARE FED UP with multiple visits by drug reps, and some are banning them from their offices.

SALES REPS SOMETIMES PRESS DOCTORS TO PRESCRIBE drugs to treat conditions for which they have not been approved. This has sparked many embarrassing government investigations.

EXCESSIVE ADVERTISING AND SALES-FORCE SPENDING lead consumers to believe Big Pharma cares more about profits than protecting health.

HOW WILL DRUG COMPANIES RESPOND?

THEY MAY DEPLOY FEWER REPS with better grounding on what the drugs can and cannot achieve.

SALES VISITS CAN BE SUPPLEMENTED WITH TECHNOLOGICAL TOOLS, such as educational Web sites where doctors can learn what they need to know.

COMPANIES MAY RECRUIT 'KEY OPINION LEADERS,' physician in local markets who can lead seminars for other potential prescribers. But this may not assuage critics.

A close-up portrait of Tina Brown-Stevenson, a woman with dark hair and glasses, smiling warmly. She is wearing a dark top and a small earring. The background is a soft, out-of-focus blue.

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CAPITOL HILL

HEALTH-CARE REFORM IS IN THE AIR, BUT...

Despite all the big talk and odd alliances, expect only small steps for now

BY RICHARD S. DUNHAM

AFTER 15 YEARS OF intermittent warfare over health care on Capitol Hill, détente has been declared. "The sun and moon may be coming together," says Federation of American Hospitals President Charles N. Kahn III, architect of the "Harry and Louise" commercials that helped doom Bill and Hillary Clinton's efforts at health-care reform. Now, says Kahn: "There's more hopefulness."

The manifestations of this brave new world are everywhere: strange partnerships between the Service Employees International Union, the Business Roundtable, and the AARP. Bipartisan coalitions on Capitol Hill. More than a dozen proposals to remedy the agreed-upon ills.

Yet for all the big talk, few expect big changes. For starters, Democrats, business groups, and their allies do not believe their vision of near-universal health coverage would be acceptable to the Administration. President Bush's plan for a health-care tax deduction, unveiled

in his Jan. 23 State of the Union address, seems likely to sink as a result of Democratic opposition. But that doesn't mean there won't be smaller developments that could help to slow the mounting liabilities for companies struggling to cover workers' medical costs. So where

Americans are eager for a fix

In polls, health care has passed the economy, unemployment, and terrorism as a top domestic concern

Q: Which issues should be a **TOP PRIORITY** for President Bush and Congress this year?

REDUCING health-care costs	68%
TAKING STEPS to make the Medicare system financially sound	63%
PROVIDING insurance to the uninsured	56%

Data: The Pew Research Center for the People & the Press. Telephone poll conducted Jan. 10-15, n=1,708 adults; margin of error, +/- 3 percentage points.

ACROSS THE AISLE
Enzi and Kennedy are backing a bill to improve health data

is progress in likely?

One bipartisan bill expected to gain traction would improve

information technology in the health care industry. Pushed by President hopeful Senator Hillary Clinton (D-N.Y.), Senate Health Committee Chairman Edward M. Kennedy (D-Mass.), and senior committee member Mike Enzi (R-Wy.), the bill is designed to save \$130 million by reducing paperwork, duplication, and medical errors. It would set standards for the exchange of electronic health-care information by doctors and hospitals. And it would give grants to medical consortiums to create regional data networks.

Another popular measure from Enzi and Senator Ben Nelson (D-Neb.) would allow small businesses to join in insurance-purchasing pools in order to lower premiums.

The most likely area for bipartisan success is health coverage for uninsured children. The federal child health program known as "SCHIP" (State Children's Health Insurance Program) is up for renewal this year. Business groups and activists are pushing a provision that would sign up poor kids for SCHIP when they are enrolled in other need-tested programs such as reduced-price school lunches. Its estimated cost: \$1 billion over five years. Congress is also likely to encourage states to continue their experiments with health coverage by giving them grants to pursue innovative approaches.

One measure not likely to pass: the President's plan for a \$7,500 tax deduction for individuals and \$15,000 for families with health insurance. Workers with insurance plans worth more than \$15,000 per year would have to pay the income tax on the difference. Democrats say the plan targets generous union health packages and would prompt companies to drop employee coverage. A key lawmaker, Representative Peter Stark (D-Calif.), accuses Bush of trying "to destroy the employee-based health-care system."

The business-labor coalition knows other partisan eruptions are coming, but vows to keep their eyes on the ultimate prize. Ronald F. Pollack, executive director of Families USA, a liberal advocacy group, says: "This is not a one-night stand." ■



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EXECUTIVE SUITE

AT CITI, MORE HEAT ON CHUCK PRINCE

New questions after he fires one executive, moves another, and searches for a CFO

BY MARA DER HOVANESIAN

CITIGROUP CHIEF EXECUTIVE Charles O. Prince III faced a difficult decision in late January: move now to announce his plan to replace Chief Financial Officer Sallie Krawcheck or wait until he had lined up a successor. For better and for worse, Prince chose to act now.

Analysts and investors had long complained that Krawcheck, 42, wasn't suited for the CFO job. Big commercial banks have struggled with profit margin squeezes lately as long-term interest rates dipped below short-term rates, making it difficult to borrow cheaply and lend for profit. But Citi has done a particularly poor job of managing those fluctuations, analysts say. "The bank's profit margin issues weren't just a function of the macroeconomic environment; management could have made better balance-sheet decisions," says Michael W. Holton, portfolio manager for the T. Rowe Price Financial Services Fund, which owns shares of Citigroup.

What's more, critics say, communication from the CFO office has been poor. "The CFO should connect the numbers to the fundamental and strategic story that the CEO is telling," says John E. McDonald, analyst at Banc of America Securities. "That communication effort has been disappointing."

Prince's chance to act came this week, when allegations of lavish spending in Citi's wealth management group prompted a management shakeup. On Jan. 22, Prince ousted 45-year-old wealth management head Todd S. Thomson and replaced him with Krawcheck. Two years ago, Thomson

Todd Thomson is ousted after allegations of lavish spending



KRAWCHECK
Was sent back to her old job

had been CFO until he was replaced by Krawcheck, who had been running wealth management. Her move is widely perceived as a demotion. Krawcheck says she was unhappy in the CFO role during two years of "messy quarters" in which "it was difficult to deliver a clean, crisp story in the face of enormous skepticism." Adds Krawcheck: "I was brought in to help them make tough decisions and not to enhance my reputation on the outside." Prince says he's "very happy with the job that she did," and the move "without qualification was a promotion." Thomson declined to comment.

By making the announcement, however, Prince created a whole new set of concerns. He says he expects to name a replacement within 60 days, and has hired executive search firm Prince & Goldsmith to review internal and external candidates. Meantime, the uncertainty is likely to weigh on staff, investors, and analysts alike. And the latest executive shuffle leads naysayers to the unavoidable conclusion that Citi lacks a deep bench of talent. Ted Brown, a hedge fund manager with Second Curve Capital in New York and a longtime Prince skeptic, wrote on his blog that "Citi's top management made up almost entirely of players who simply aren't up to the job."

Prince seemed to be gaining momentum of late. Investors pushed up Citi's share price by 10% since December—the first meaningful uptick in the three years that Prince has been at the helm. But recent about-faces on strategy and once again raising doubt about his stewardship over the behemoth bank, which has \$1.8 trillion in assets at a stock that continues to lag badly that of peers such as Bank of America and Goldman Sachs.

For months, Prince has vociferously defended his decisions to invest in overseas operations as well as new branches in Philadelphia and Boston, and he vowed not to bow to investor pressure to produce short-term results. But by December, he had

slashed 2007 investment projections in half. Prince also made a public show of support for his managers and recently assured analysts and investors that the executive team would remain intact and recently singled out Krawcheck by name. "The last six weeks have not been well orchestrated, and the buck stops with Prince," says David A. Hendler, an analyst with CreditSights, a bond research shop in New York.

Prince's toughest challenge, though, is a familiar one: growth. Citi generated earnings per share of 98¢ in the fourth quarter of 2005; by the fourth quarter of 2006, they clocked in at just \$1.03. During that same period, competitor Bank of America's earnings jumped from 89¢ to \$1.19. It doesn't take a Wall Street CFO to spot the problem there. ■



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PETROLEUM

OIL: IT'S BACK TO SUPPLY AND DEMAND

The speculators who bid up the market last year are in retreat. So much for the new reality

BY ROBEN FARZAD

LAST JULY, WHEN CRUDE OIL was surging toward \$80 a barrel, the talk of a new reality in the energy markets hit a fever pitch. Some said China and India would so voraciously suck up supplies that we might never see \$50 a barrel again. Others noted that the nations that make up OPEC had finally figured out how to put the screws to the West for good, emboldening Iran and Venezuela to send prices higher with a mere rattle of their sabers. The "multi-decade supertrend" mantra echoed through the canyons of Wall Street.

Then oil crashed, touching \$50 in January, 35% off its peak. Since July, in fact, crude has underperformed the stock market by 48 percentage points (chart). All this while China's oil-thirsty economy remains white-hot, Iran is barring nuclear inspectors, Venezuela is booting foreign oil investors, and Russia is putting the energy squeeze on neighbors.

So what happened? Call it a return to normalcy. The speculators and latecomers who bought into the new-paradigm argument suddenly turned tail—and traditional drivers of the oil market reemerged in force.

The biggest: old-fashioned supply and demand. Last week, prices fell when the Energy Dept. said it had tallied just under 322 million barrels of domestic crude oil stockpiles, a 6.8 million-barrel increase for the week and 9.3% more than the five-year average. Then, on Jan. 23, prices rose after the U.S. announced plans to double the size of the strategic petroleum reserve during the next few de-

cadec—promising, in essence, to take supply off the market. But that wasn't enough to demoralize the oil bears, who growled the very next day after another report showed brimming stockpiles. The upshot: The self-correcting forces of Economics 101 still apply to oil. "Cycles come and cycles go," says Oppenheimer & Co. oil analyst Fadel Gheit. "This is a commodity. There is no physical reason for it to have gone to \$80." Gheit and others say the true supply-demand equilibrium for oil is closer to \$45 a barrel.

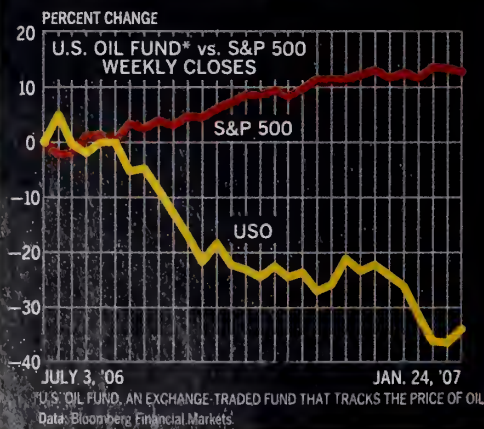
PLUNGE IN FUTURES

AT LEAST FOR NOW, the inventory glut has derailed the speculators' easy money story. Philip K. Verleger Jr., an Aspen (Colo.) energy economist, witnessed the risk-free bet of financial players buying oil cheaply on the spot market, storing it, and contracting in the futures market to sell it later at a chunky premium. "The investment banks were able to lock in 50% and 60% rates of return where they owned storage facilities," he says. Now, the pendulum has swung

the other way. According to data from the Commodity Futures Trading Commission, speculators' total position in crude oil futures plunged from a "net long" (or bullish) position of 75,000 contracts in August to a "net short" (or bearish) position of 2,032 contracts last week. One trader posits that the ferocity of oil's recent fall means more of his peers are subscribing to the idea that "someone is in trouble." He adds: "I wouldn't be shocked if we had another Amaranth [Advisors] come out of this," referring to a multibillion-dollar hedge fund that collapsed in September after making an ill-timed bet on natural gas futures. Says veteran oil industry analyst Charles T. Maxwell of Weeden & Co.: "Usually, this goes to excess. Someone gets hurt, and more people will say it's time to pack their bags and go home."

Other financial institutions are scrambling to adjust. Fidelity Investments' \$69 billion Contrafund, the largest mutual fund at the country's largest fund company, dumped energy laggards that contributed to the fund's having trailed the Standard & Poor's 500-stock index by four points last year. Firms such as Deutsche Bank and Barclays PLC that lent their name to oil-heavy exchange-traded funds

A TALE OF TWO MARKETS





The bulls ignored Econ 101 and had a rough landing

returning to form: OPEC, which has lately demonstrated its classic inclination toward ineffectiveness. According to Bank of America Corp. research, OPEC export revenue should plunge to about \$84 billion by the second quarter of 2007, down from a \$126 billion peak in the third quarter of 2006. To compensate for the unexpected shortfall, OPEC has been selling U.S. Treasuries at the fastest clip in more than three years. Last week, the Saudi oil minister voiced opposition to cartel members' desire to hold an emergency meeting to address oil prices. OPEC's late-2006 pledge to cut by 1.2 million barrels per day starting on Nov. 1 and by an additional 500,000 barrels before Feb. 1 has fallen on deaf ears, primarily because the cartel hasn't yet made good on the first part of the pledge. "How can you cut more if you haven't even fulfilled your first production cut? OPEC can't just jawbone the market anymore," says Gheit.

It's anyone's guess where oil prices will go from here. Not that this is stopping the supply-demand school from enjoying a bit of vindication. "There were times when I felt like the class clown," says Benchmark Co. oil and gas analyst Mark Gilman, of the way his skepticism was received when oil hit \$78. "All of a sudden my thoughts aren't so funny." ■

—With Peter Coy

ETFs) must now contend with the as-class hitting a two-year low. "People are piling into commodity ETFs," says Bill O'Grady, assistant director of market analysis at St. Louis-based A.G. Edwards & Sons. "Now, the 25% pullback is scaring the heck out of them." For all the fast action, O'Grady's statistical research finds that the recent

commodities bull market was, contrary to conventional wisdom, very much cyclical—and in fact was a tiny blip within a 100-year trend of falling commodity prices (adjusted for inflation). "The idea that this commodities run would be permanent kept resonating with investors," he says, "until it didn't."

Another oil-market driver seems to be

VENTURE CAPITAL 2.0

MAKE-OR-BREAK TIME FOR THE NET NEWBIES

As shakeout fears rise, startups are spending furiously to break from the pack

BY HEATHER GREEN

IT'S A FORMULA THAT HAS FIRED up Internet entrepreneurs from Palo Alto to Paris: Start with free software, add falling prices for computing and data storage, toss in ever-cheaper distribution costs, and you can launch an online service for practically nothing. But now that many so-called Web 2.0 outfits have a couple of years under their belts, it's sinking in that it takes real money to turn those ideas into real businesses—to reach a broad audience, scale up operations, and, you know, turn a profit. "It's true that you can do a science experiment more efficiently than you could five years ago," says Rob Shurtleff, managing director at Divergent Ventures, a venture capital firm. "But don't confuse doing the science experiment with building a large enterprise."

For many Web companies, 2007 will be the year that difference becomes painfully obvious. They may have started out with dreams of getting snapped up by the likes of Yahoo! Inc. and Google Inc. But out of scores or even hundreds of startups in any given category, whether it's video sharing or photo slide-shows, only a handful will be bought in their first rush of success. The phenomenal triumph of MySpace and YouTube Inc. is the exception, not the rule. To complicate matters, basic expenses such as salaries, marketing, and real estate are on the rise, driven up by the very fact that so many companies were started on a shoestring.

That means raising significant money to spend on nuts and bolts.

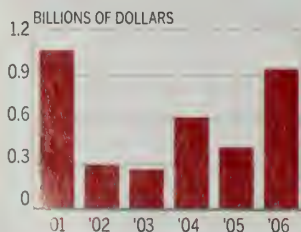
Web services may cost mere hundreds of thousands of dollars to set up. But turning them into profitable companies could cost \$15 million to \$25 million, much of which must be spent on distribution, engineering, and infrastructure, says Brad Feld, a managing director at Mobius Venture Capital Inc. Some outfits are raising even more. Brightcove Inc., a video-distribution company, has raised \$82 million, and home-appraisal site Zillow has \$57 million.

They're getting room to run because venture investment in consumer Web projects is on the rise, more than doubling in 2006, to \$943 million. And the amount that VCs are investing in each financing round is growing. Compared with the fourth quarter a year ago, the average amount per deal in a later-stage round

FUNDED 4INFO
CEO Thet raised \$16 million

ONCE AGAIN BETTING BIG

Venture investing in consumer Web outfits is the highest since the dot-com bubble burst



Data: Thomson Financial for PWC/NVCA
MoneyTree Report

has nearly doubled, to \$9.2 million. But this rapid rise in funding sets up an inevitable day of reckoning.

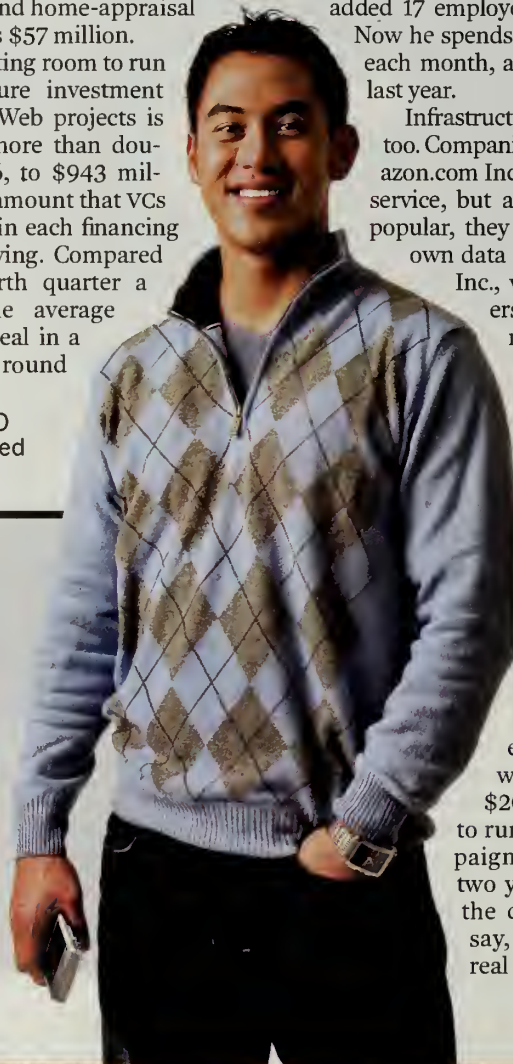
'DARWINISM'

IF THEY CAN'T PROVE their business models or break from the pack, Web companies risk becoming part of a shakeout that observers expect to really get going in 2008. "We're still a year or two away from the bigger market segments like social networking, user-generated video, and vertical search showing real Darwinism," says Todd Dagres, general partner at VC firm Spark Capital. Some winnowing has already begun.

One of the biggest costs of scaling up is adding employees. After launching a startup with two or three friends, founders soon realize that, no matter how much they work, they can't answer all the e-mail or put out all the features they want. So they hire customer service reps and engineers. That's the case at 4INFO, a mobile search service that has raised \$16 million to dish up weather updates, sports stats, and local restaurant listings to cell phones. Last year, CEO Zaw Thet added 17 employees, for a total of 30. Now he spends just under \$500,000 each month, about 60% more than last year.

Infrastructure can get pricey, too. Companies may start with Amazon.com Inc.'s cheap data storage service, but as they become more popular, they must invest in their own data facilities. FeedBurner Inc., which helps publishers distribute and manage money from blog ads, has spent nearly 20% of its \$10 million in funding on upgrading data centers.

Even a search engine marketing campaign—the most basic means of getting attention—is becoming prohibitive. Ellen Siminoff, CEO of marketing firm Efficient Frontier Inc., estimates that it would cost a startup \$20,000 a month now to run a worthwhile campaign, up from \$5,000 two years ago. As vets of the dot-com bust might say, welcome to the real world. ■





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TELEPHONES

CHINA MOBILE'S HOT SIGNAL

It's already the world's biggest cellular carrier. Now it's planning to get even bigger.

BY DEXTER ROBERTS

DAGOU CUN FEELS LIKE the kind of place that progress missed entirely in its sweep through China. Nestled at 10,000 feet in the pine-studded foothills of the Tibetan plateau, the village is little more than a few dozen stone houses and a Buddhist shrine. Getting there from the nearest big city, Chengdu, takes five hours by car, much of it on a muddy, rutted road.

But given the electronic trills emanating from the fields of barley, potatoes, and corn, it's clear that the 21st century has finally made it to Dagoucun. Last year, the village got cell-phone service, dramatically transforming the way its residents live and work. With better information about crop prices delivered to their phones, farmers have started planting more marketable crops such as Chinese cabbage and herbs for traditional medicines. And they no longer have to truck their produce to distant cities in hopes of finding buyers. "Before, we had to travel 20 kilo-

meters to make a phone call," says village chief Xie Sufang, a 65-year-old mother of seven. "Now we contact the buyers, and they come to us."

The company responsible for bringing change to this rural outpost: China Mobile Ltd. Since it was spun off from fixed-line operator China Telecom Corp. in 2000, China Mobile has grown into the world's biggest cellular carrier. The company is signing up nearly 5 million new customers a month and recently topped the 300 million mark—more than the entire population of the U.S. In 2006, revenues grew 21%, to \$37.8 billion, and net income 23%, to \$8.7 billion, estimates Deutsche Bank. And its Hong Kong-traded shares more than doubled in the past year, giving Chi-

na Mobile a market capitalization of \$198 billion and making it the most valuable cellular carrier on earth. The company also has global ambitions: On Jan. 22, it announced it was buying 89% of Paktel Ltd., Pakistan's fifth-largest cellular carrier.

China Mobile built its early success on urban China. Problem is, just about



DAGOU CUN
Life is being transformed by cell phones

MARKET LEADER



everyone in mainland cities who can afford cellular service already has it. Mobile-phone penetration in Beijing, Shanghai, and Shenzhen is approaching 100%. So to keep growing, China Mobile is plunging ever deeper into the interior, building cell towers from the deserts of Inner Mongolia to the mountains of Tibet. In rural China, home to 700 million, just over 1 in 10 people has a cell phone. "It is a market with huge potential," says China Mobile Chairman Wang Jianzhou.

China Mobile's torrid growth has escaped the attention of Western companies seeking to tap the potential of China, both urban and rural. The carrier has inked agreements with Vodafone Group, News Corp., Viacom's MTV Networks, and the National Basketball Association, among others. Last summer, China Mobile launched a music-download service



d M.Music in partnership with Sony, Universal Music Group, EMI, and Warner Music. And on Jan. 4, Google announced that its search engine would be featured on China Mobile's internet mobile phone portal.

What's behind the flurry of deals? "We want to make the cell phone into a multimedia medium," says Wang. The company is aggressively pushing extras such as games and music downloads. Demand for such services is expected to surge with the launch of third-generation (3G) mobile technology in time for the Beijing Olympics in 2008. Beijing telecom consultancy BDA China estimates revenues from such services will jump from \$10.4 billion last year to \$28.6 billion by 2010. Wang believes his company's continued dominance of China's cell-phone market will depend on the news, entertainment, and music it can beam to subscribers. So

The plan is to tailor rural services to farmers, give urbanites extras, and apply the strategy to other emerging markets

in June, China Mobile plunked down \$166 million for a 19.9% stake in Phoenix Satellite Television Holdings, the mainland's most popular cable news and entertainment channel.

China Mobile is also turning its sights overseas. Its \$284 million purchase of Paktel, likely to conclude in late February, will be the company's first overseas acquisition, though early last year it bought Hong Kong's No. 4 mobile company, People's Telephone, with 1.1 million subscribers. Last summer, China Mobile made a \$5 billion-plus play for Lux-

embourg's Millicom International Cellular—Paktel's parent—which has mobile networks in Africa and Latin America as well as Asia. But negotiations broke down due to concerns about the big price tag, analysts say. While Wang declined to comment on the collapse of the Millicom talks, he says China Mobile is interested in acquisitions in other developing countries: "We are familiar with emerging markets. Their experiences may be very similar to ours."

Wang has plenty to keep him busy at home as the government turns up



the competitive heat on the cell-phone industry. Until now, China Mobile has had to contend with just one rival: China Unicom Ltd. Like China Mobile, Unicom is listed in Hong Kong and is state-controlled. With 143 million subscribers, though, Unicom is a distant No. 2, which some attribute to the complications it faces in maintaining a network that uses two mobile standards. China Mobile, by contrast, can operate more efficiently using a single technology, the GSM standard developed in Europe. Sometime this year, Beijing is expected to award 3G licenses to both current carriers and also possibly to two new rivals, most likely China's state-owned fixed-line operators, China Netcom Group and China Telecom.

PROFIT PUSH

CHINA'S LEADERSHIP could complicate life for Wang & Co. in other ways, too. In an effort to boost its international prestige, Beijing is pushing the development of a homegrown 3G standard not used elsewhere. China Mobile, China Netcom, and China Telecom are all currently running trials of the new technology. But analysts expect China Mobile to win the dubious honor of leading the rollout, which could be a costly distraction that will almost certainly be more complex than introducing one of the 3G standards already deployed in other countries. Being forced to build a network using China's technology "definitely is a liability," says Zhang Dongming, director of research at consultancy BDA.

Even with a smooth rollout of 3G, China Mobile could have a tough time

keeping revenue and earnings growing at double-digit rates. As it pushes ever deeper into the interior, the company faces the same dilemma as the likes of Procter & Gamble Co. and General Motors Corp.: how to win new customers without sacrificing profit margins. Incomes in rural China average just over \$400 per year, or less than one-third what city dwellers earn. To drum up business in places such as Dagoucun, China Mobile is cutting prices, and the amount of money it gets from each subscriber has declined modestly in the past year, to about \$11. "The key is to maintain profitability even while penetrating rural areas," says Steve Zhang, CEO of Beijing's AsiaInfo Holdings Inc., a telecom software and services company that works with China Mobile and other mainland carriers.

Telecom Titans

The world's biggest cellular companies*

OPERATOR	SUBSCRIBER ACCOUNTS (MILLIONS)**	AVERAGE REVENUE PER USER***
CHINA MOBILE	300	\$11.19
CHINA UNICOM	143	6.80
CINGULAR	60	49.76
VERIZON WIRELESS	59	50.59
SPRINT USA	54	52.25

*Single-country operators **Q4-2006 estimates
***Monthly in Q3-2006. Data: Wireless Intelligence

Wang insists he's not jeopardizing earnings. One reason, he says, is that China Mobile runs a much leaner operation in the countryside. It has largely dispensed with stores and is instead relying on village chiefs such as Xie to persuade neighbors to buy handsets and prepaid cards. China Mobile offers cell-phone plans tailored for farmers that include information such as crop prices and tips on duck breeding delivered via text message, the Internet, and a call-in phone service. The plan costs a nominal 25¢ a month, but users must pay extra to place calls and send text messages. Since its launch in October, the service has been rolled out

M-ZONE A
\$2 monthly plan aimed at music-mad young people

12 provinces in western China and is expected to go nationwide later this year. "Our main purpose now is to provide farmers with information that benefits them

says Qin Dabin, vice-general manager of China Mobile's operations in the western city of Chongqing. Although it will take some time before the initiative turns a profit, Qin says it's helping to attract subscribers.

China Mobile isn't abandoning cities either. Far from it. The company has an upscale service called Go-Tone for businesspeople. The \$6.40 basic monthly fee (phone and message charges are extra) includes reduced membership rates at golf courses and access to VIP waiting rooms at many Chinese airports. And a \$2-a-month plan called M-Zone is aimed at music-mad teenagers and twentysomethings. China Mobile puts on special events for M-Zone members such as appearances by the likes of Chinese-American pop star Pan WeiBo.

Meanwhile, back in the mountains of Sichuan, villagers are figuring out more ways to wring money from the new phones. Cabbages from Dagoucun now travel all the way to the southern cities of Guangzhou and Shenzhen as it's easier to reach buyers across the country. Villagers have sold a rare caterpillar fungus—prized in Asia for its antiviral attributes—to customers in Singapore that were contacted via cell phone. And residents are building a three-story lodge for mountain climbers and anglers in a bid to transform their remote village into a flourishing center for ecotourism. "With our mobile phones, potential tourists can contact us and learn more about our village," says village chief Xie. "We can increase our incomes in many ways." ■



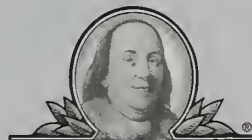
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^{††}Source: Strategic Insight, 11/30/06. Based on long-term tax-free income fund assets.

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SILVERJET Will the airline avoid the fate of other failed luxury startups?

AIRLINES

BUSINESS CLASS AT BARGAIN PRICES

Silverjet and other fledglings aim to steal corporate travelers from the majors

BY KERRY CAPELL

LIFE HAS NEVER BEEN more full of possibilities for stressed-out business travelers looking for some seclusion at 35,000 feet over the Atlantic. In a little over a year, a slew of startup carriers has taken to the skies with business-class-only planes that let the well-heeled avoid rubbing elbows with the hoi polloi. The first was Eos Airlines, which flies just 48 people, instead of the standard 220, on its Boeing 757-200s between London and New York. Meals are gourmet, beds are truly bed-like, and the blankets cashmere. Eos was soon followed by MAXJet, with spacious seats at near-economy prices. Then in January, French startup L'Avion kicked off a premium service from Paris to New York. And the latest entrant, Silverjet PLC, was slated to start serving the New York-London route on Jan. 25.

Will they really be able to fill all those plush seats? The new carriers charge anywhere from \$1,000 to \$3,500 for a round-trip ticket, compared with as much as \$8,000 at established airlines. And lower prices don't mean shabby service. At Silverjet, for instance, passengers can sip cocktails while a concierge handles check-in via laptop. All told, it may be enough to sway small businesses and leisure travelers looking for a comfier ride. "If you reduce a business class fare to under \$2,000 you'll convince a lot of passengers to upgrade," says Silverjet founder Lawrence Hunt.

Some industry insiders, though, doubt there's

enough demand to keep all the flying paces aloft. Airlines tend to burn through piles of cash in any downturn, and the new carriers lack the big fleets and flight frequency of giants such as British Airways PLC. Silverjet currently offers just one New York-London round-trip a day while BA has a dozen. "If you take one plane out of service at BA, no one notices," says Richard L. Aboulafia, an analyst at aviation consultant Teal Group in Fairfax, Va. "If you do it at any of these carriers, you annoy an awful lot of people. Worse for the small-fry, they tend to serve less-convenient, outlying airports, and the majors cut low-cost deals with big spending corporate customers.

STRONG TAILWINDS

WHAT'S MORE, the majors are splurging on improvements to their service. Last year, Virgin Atlantic Airways Ltd. rolled out a \$23.5 million revamp of its premium economy class aimed at the same cost-conscious business passengers the upstarts are trying to lure. And BA is spending close to \$200 million to upgrade its business- and first-class services with goodies such as wider beds and privacy screens that slide into place at the touch of a button.

The majors, though, will never be able to ratchet costs down as low as the startups can. Similar to discount carriers, the newbies fly only one type of aircraft point-to-point, saving on maintenance while avoiding the costs of vast hub-and-spoke networks. The upstarts are benefiting from other strong tailwinds, too. Fuel prices have been falling, the economy is doing well, and business travel is picking up. And big airlines are upgrading their fleets, so it's easy to find second-hand planes at knock-down prices.

Still, aviation history is littered with failed luxury startups. Remember MGM Grand Air? Founded by financier Kirk Kerkorian in 1987, the airline struggled to fill the plush

33-seat Boeing 727s it flew between Los Angeles and New York and was eventually sold to a charter company. "Others who tried to get into this market," says Michael Boyd, an aviation consultant in Evergreen, Colo., "found that instead of Kobe steaks and champagne, what passengers really want is frequency and convenience." ■

—With Reena Jana in New York

THE STAT

\$1,950

New York-London round-trip on Silverjet, compared with \$8,063 for business class on British Airways*

*Prices as of Jan. 23, two week advance purchase

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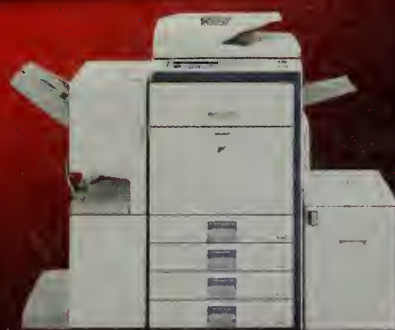
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The Real Value Of Vista

Microsoft's new Windows will allow you to make the most of your digital media

BY JAY GREENE

WHEN VISTA FINALLY hits the shelves on Jan. 29, most consumers won't have a clue why they should buy it. Never mind the fanfare it will receive as Microsoft Chairman William H. Gates III formally launches the new Windows from the stage of the Nokia Theater in New York. Or the hundreds of millions of dollars the software giant plans to spend through June to market it. With all of Vista's many new features, Microsoft seems incapable of really zeroing in on the handful that will truly change the way consumers use their PCs.

Not that Vista won't be a step forward. Just think back to what your PC was like five years ago when Windows XP launched. It was still the era of the Blue Screen of Death, that infamous window that popped up to say your PC had just crashed. Windows XP improved PC reliability. But in retrospect, the real breakthrough for consumers (those who didn't already have a Mac, that is) was XP's ability to help digitize their entertainment. Windows XP made it a snap to stash music, photos, and video online.

Windows XP pretty much stopped right there, though. Microsoft Corp. made it easy to rip a CD to your PC's hard drive. But it took Apple Inc., with its iPod, to figure out how to actually take advantage of that digitization and make it easy for consumers to listen to their digital tunes. And forget about photos. Consumers have snapped scads of photos—2 billion in 2006 alone. But they remain trapped on hard drives of PCs running Windows XP. It's not all that different than storing snapshots in shoeboxes under the bed.

Enter Vista. Let's go out on a limb and suggest that for all the knocks against

Microsoft and the jokes about how long it took to crank this thing out, Vista will in time be recognized as a leap past XP. And not just because it is far more secure and boots up more quickly. When consumers look back a few years from now, the Vista improvement they may be most likely to cite is the ability to actually use all that digital content they've been accumulating over the years.

The result of Microsoft's efforts is a collection of devices and services that takes Windows a step closer to truly being a digi-

New Ways To Do Windows

Microsoft's Vista, with the help of partners, should make it easier to play music and movies and view photos.



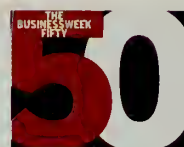
PHOTOS You can transmit pictures from your PC to places around the house using the Memento digital photo frame from i-mate and Vista's ability to let devices easily plug in and associate with a Wi-Fi network.



MUSIC The Sonos system, which has been around for a few years, will now be able to play protected Windows Media content throughout the house. Before Vista, you couldn't play most songs purchased online.



VIDEO The Vongo movie-downloading service has been updated with Vista's Aero design, so customers with a Windows Media Center computer will have a TV-like experience finding and watching flicks.



The Best Performers

connect to PCs over a wireless network

Sounds geeky. But Microsoft has made it easy for PCs to recognize the frame on a home network, so all users need do is turn on the frame to connect to it. Then, from their PC, they can select which pictures to display on the frame scattered around the house. "A lot of success of Vista will be up to the partners like us to make it dead simple," says John Grindeland, director of sales for i-mate PLC, a Dubai company whose \$299 Memento 10-inch frame goes on sale with Vista launches.

FREEING THE MUSIC

ANOTHER GADGET, the Sonos Digital Music System, was wowing gearheads long before Vista came along. The Sonos system lets customers shoot music wirelessly from PCs to speakers throughout the house. And it worked well, except for music purchased online that contained

copy protection preventing it from playing on multiple devices. Windows Media Center's music technology in Vista, fixes that, letting users stream copy-protected content throughout the house.

None of this was easy for Microsoft, which has always done better with business than consumers. "We've really focused on creating a consumer brand for Microsoft," says Brad Brodeur, general manager in the Windows Client group. Microsoft's critics will point out that many Vista features are already in Apple's Mac OS X. Even Vista's new method of recovering old versions of files, with the drab moniker Volume Shadow Copy, traces its roots to Apple's much flashier Time Machine technology.

But for most PC users, these improvements will matter regardless of who has them first, says Michael Gartenberg, research director at JupiterKagan Inc. After Vista, like its predecessor, will continue to outsell the Mac by 20 to 1. ■



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EDITED BY
CATHERINE ARNST

INNOVATIONS

Tobacco craving and beta-carotene genes

>> A region of the brain called the insula, which regulates feelings, plays a key role in smoking addiction. If it's damaged, even longtime smokers lose the urge to light up, according to doctors from the University of Iowa and the University of Southern California. They stumbled on this discovery when a man who had been smoking 40 cigarettes a day suffered a stroke and quit without effort. They then studied 69 smokers with brain damage; of the 19 with damaged insulas, 13 quit smoking.

>> Cauliflower isn't just good for you—it may be good for other vegetables. Scientists at the Agriculture Dept. say they've isolated an orange cauliflower gene that promotes high beta-carotene accumulation in plant tissues. Biologist Li Li of the department's Plant, Soil & Nutrition unit is trying to use the gene to induce high levels of beta-carotene in other food crops. The human body uses this substance to make vitamin A, which is essential for eye health and the immune system. Vitamin A deficiency affects 250 million children worldwide and is the leading cause of childhood blindness.



BIOTECH NATURE'S ANTIDOTE TO NERVE GAS

HUMAN BLOOD has a protein that can sop up nerve gases, rendering them harmless, but the levels are too low to save people who are exposed. Two research teams, both backed by the Defense Dept., are testing bulk-produced quantities of these bio-

scavengers as vaccines or post-poisoning antidotes.

DynPort Vaccine is in the lead. The Frederick (Md.) unit of Computer Sciences began clinical trials in January, injecting 20 adult volunteers with butyrylcholinesterase, a protein derived from plasma.

PharAthene of Annapolis, Md., is producing a recombinant version of the protein in the milk of transgenic goats. It aims to move to human trials in 2008.

—Michael Arndt

SOLAR ENERGY GETTING MORE BANG FROM THE BEAM

THE IDEAL solar cell would convert all the energy in a ray of light into electricity.

In practice, photovoltaics like those on rooftops capture less than 20%.

With the help of a solar concentrator, a record of 40.7% has been set, however, by scientists at Spectrolab, a subsidiary of Boeing.

The supercells rely on a special multilayered structure. Each slice captures a different bit of light's energy spectrum. In place of silicon, the material used to make most solar cells, Spectrolab uses costlier gallium arsenide. But since it's deposited in superthin layers, costs shouldn't be high.

The National Renewable Energy Laboratory estimates that the breakthrough could lead to systems priced at \$3 per watt, about half today's rate, delivering power at 8¢ to 10¢ per kwh. —Adam Aston

MALARIA AN OLD DRUG WITH A HIDDEN TALENT

RESEARCHERS AT Northwestern University say they have discovered a way to get around resistance to standard malaria treatments—one that would require the development of an expensive new drug. Propranolol, a 40-year-old medicine for high blood pressure, stops the parasite that cause malaria from hijacking the red blood cells they use to proliferate.

Malaria strikes 350 million to 500 million people each year and kills 1 million to



2 million. There is no vaccine for the disease, and the mosquito-borne parasite becomes resistant to drugs because its molecular structure can mutate quickly.

A research team led by Dr. Kasturi Haldar decided that instead of attacking the parasite directly, they would block its entry into blood cells. Working with mice they discovered that the beta-blocker propranolol caused red blood cells to reject the parasite. Left exposed, the parasites in propranolol-treated animals could be killed with one-tenth the amount of antimalarial medicine normally required.



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Keeping Lawyers Out of the Lab

Researchers gripe that suits arising from their findings waste time and hurt their reputations

BY CATHERINE ARNST

ADD ANOTHER SET OF voices to the chorus of complaints about our litigious society. Scientists who would prefer to plug away quietly in their labs say they are dragged into lawsuits the moment their research turns up a hint of the possible cause of a disease. And once that happens, they are besieged by time-consuming subpoenas from both plaintiff and defense attorneys. Their professional reputations come under attack, and any hope of privacy for their pursuit of scientific knowledge is gone.

Dr. Brad A. Racette, a neurologist at Washington University School of Medicine in St. Louis, says his experience is compelling evidence of the burdens of litigation. It started when he published a study in 2001 suggesting that welding fumes might cause Parkinson's disease. Such a link had long been hypothesized because welding rods contain manganese, a metal that in high doses is a known risk factor for Parkinson's. Racette found that 15 professional welders developed symptoms of the disease an average of 15 years earlier than normal for Parkinson's patients. Although far from definitive, it was the strongest suggestion yet of cause and effect.

The study fed into a flood of litigation, with more than 10,000 welders filing suit to date. Racette and Washington University have been served with 10 subpoenas, and he has been



we're doing research, our records contain very specific information about employers and dates and so on that make possible to identify the individuals in the study," says Racette. "That can really undermine the trust that research participants place in us."

A HEAVY BURDEN?

THE AMERICAN ASSOCIATION for Justice, a trial lawyers' group, is not convinced. "This is one person complaining about going into court twice a year for five years. That hardly seems like a burden," says Chris Mather, head of communications for the group.

Whether or not such demands are a burden depends on who is being asked. J. Steven Picou, a sociology professor at the University of South Alabama, says he spent an entire year responding to subpoenas after he published studies in 1992, funded by the National Science Foundation, on the social and psychological impact of the 1989 Exxon Valdez oil tanker spill in Alaska. Alaska residents had already filed suit against Exxon Corp. and "Exxon wanted every scrap of paper that was

RACETTE Washington University has spent \$200,000 responding to legal motions

deposed three times. "It has taken up an extraordinary amount of time," he says—one researcher in his lab dedicates almost all his time to pulling together data required by court action. Washington University has also spent more than \$200,000 responding to legal motions.

Even Racette's patient data are up for grabs. As a treating physician, he had assumed medical records were protected by the Health Insurance Portability & Accountability Act (HIPAA), designed to shield patient privacy. But a court order trumps HIPAA. Lawyers have a broad right to request detailed medical information if it pertains to a case. "Because

all relevant," he says. "It was very distracting, very distressing." The litigation also stopped Picou's research team from publishing any further studies of the spill, for fear of more legal demand. Lawsuits surrounding the Exxon Valdez spill are still in the courts.

Racette refuses to serve as an expert witness for either side of the welding suits, but Washington University has accepted \$230,000 from a trial lawyers' group to cover the costs of screening welders for Parkinson's. John Beisner, a partner with O'Melveny & Myers who represents welding companies, says that makes information gathered on those welders fair game in discovery. "It should not be a surprise that a defendant would ask for the details of information that is used against him," Beisner agrees that such searches should be done in a way that doesn't chill scientific research, but adds that "the courtroom is the place where you search for the truth," and

THE STAT

10

Number of subpoenas received by Dr. Brad Racette since he reported a potential link between welding and Parkinson's disease in 2001

cientific studies fall into the purview of that search.

Racette and a colleague, Dr. Joel S. Perlmutter, laid out their side of this conflict in an article in the December issue of *Neurology*, written after Racette attended conference over the summer on metal toxicity. "I found that many people have these stories," he says. "It absolutely has a chilling effect on research. When investigators see the difficulties faced by other researchers, their natural reaction is to do something else to do."

Racette says scientists are particularly concerned about attacks on their reputations by industry attorneys seeking to discredit research. For proof that such fears aren't groundless, they need only look to Dr. Herbert Needleman, a professor at the University of Pittsburgh. In the 1970s, Needleman was the first scientist to link lead exposure and lowered IQ levels in children. Although his research persuaded the federal government to mandate the removal of lead from gasoline and paint, Needleman was ferociously attacked by the lead and paint industries and had to defend himself against charges of scientific fraud and misconduct. He was ultimately exonerated—after tallying up \$85,000 in legal expenses.

The American Association for the Advancement of Science became aware of the disruption that litigation can cause the scientific process seven or eight years ago, during lawsuits involving tobacco. "Attorneys for those companies were very aggressive in seeking data from scientists," says Mark S. Frankel, director of the Scientific Freedom, Responsibility & Law program at the AAAS. "One doctor left the field, he was so discouraged."

Picou, who has monitored lawsuits involving research ever since his own work came under scrutiny, worries that the legal system also devalues the scientific process. "Issues other than scientific evidence come into play in a lawsuit. It involves how good your attorney is and how good you are on the witness stand. Scientists become trapped in a battle between experts."

Racette calls for federal legislation that would protect research from subpoenas. As a model, he points to Illinois' Medical Studies Act, which prohibits the legally forced disclosure of data obtained in a medical study. "We need to create an environment where scientists are free to explore many different potential causes of disease, without having to worry about being hauled into court." ■



How to Take the Reins At Top Speed

Getting a jump on a new job before you begin is critical. Enter coaches and consultants

BY JENA MCGREGOR

BORROWERS HAVE THEIR grace periods. Married couples have their honeymoons. And new corporate leaders have long had their "first 100 days." For CEOs, at least, that's the approximate time between a new job's starting line and Wall Street's first quarterly day of reckoning.

But that window of forgiveness, often characterized by promises to go on listening tours and polite calls for patience from investors, is closing quickly. In today's era of increasingly activist investors and boards, a heightened focus on fast results is making the first few months feel more like a trial by fire than

a honeymoon. "Boards are more willing to toss people out and [are giving CEOs] a much shorter leash," says Michael Watkins, author of *The First 90 Days* and a former Harvard Business School and INSEAD professor. "Many senior executives feel they have a much shorter time frame to prove themselves."

That may be wreaking havoc in some boardrooms, but it's creating opportunities in others. Executive search firms, leadership coaches, and consultants are building specialized "executive onboarding" services to add to their client offerings. Onboarding, as the name implies, helps new managers get a running start through coaching that assists them with detecting cultural nuances, accelerating strategic plans, and navigating

the personality mine fields of their new teams. The term is also now used to describe orienting new hires.

Despite having a name only a consultant or HR professional could love—onboarding is also known as management integration or, worse, assimilation coaching—the practice is taking off. Headhunters Egon Zehnder International and Heidrick & Struggles International both report rising levels of interest from companies for their onboarding services. In 2005, Korn/Ferry International, which also consults with new leaders through its coaching division, helped launch a “CEO Boot Camp,” a two-day seminar for new chief executives, in conjunction with the Wharton Club and PrimeGenesis, a consulting firm that specializes in executive onboarding and which says demand for its services tripled in 2006.

EARLY WARNINGS

IF SUCH coaching strikes you as either common sense or as the kind of skill you would expect top executives to have already developed, you wouldn't be alone. Tamara Minick-Scokalo, who hired PrimeGenesis managing director George Bradt three weeks into her last job as senior vice-president for Europe of Elizabeth Arden Inc., was skeptical at first, too. “I thought that a company hiring you in at that level would expect [that you'd have those skills],” she says. But Minick-Scokalo, who had worked with Bradt at Coca-Cola Co. in the past, knew her new job would be a challenge. Not only was she switching industries, from wine (she had been European general manager of E. & J. Gallo Winery) to cosmetics, but her role would be a new one, designed to help accelerate the company's international growth.

Bradt, who has also worked with Merrill Lynch, MTV, and Miller Brewing, helped Minick-Scokalo spot peculiarities in Elizabeth Arden's culture. He assisted her and her team in crafting a strategic plan in three months—about half the time, she says, it would have taken her on her own. And he helped alert her to po-

tential clashes with new colleagues who would no longer have direct access to people who now reported to her. “He spotted things I would have tripped over,” says Minick-Scokalo. In her newest post, as president for global commercial at Cadbury Schweppes PLC, she hired Bradt again, this time to work with her and her team, but also to help her

es. At a time when CEO failure rates running at 40%, after all, helping executives “stick” makes sense. “It's like an insurance policy for your placement,” says Rich Rosen, a partner in Heidrick's leadership consulting practice.

It also raises questions about inherent conflicts. Watkins, whose leadership consulting firm has a relationship with coaching outfit Lore International Institute, questions whether executive search consultancies can also make good coaching partners. “The culture of search and the culture of coaching and onboarding are like chalk and cheese,” Watkins says. “One is much more transactional and one is much more relational.” He notes, too, that companies can be wary of search firms hanging around after placing an executive. “They don't necessarily want search firms as deeper in their talent pool,” he says.

Executive search firms counter that where coaching relationships exist, they're careful to maintain leadership teams off-limits to recruiters. And they note that headhunters are not necessarily trying to double as coaches. “We're training our search consultants to recognize a need,” says Joseph E. Griesedieck, Vice Chairman of Korn/Ferry International. “And then they bring in the people who are experts.”

Other large search firms have avoided making onboarding a formal service

so far. “We really like to think of this as an integrated part of our recruitment process,” says Spencer Stuart's James M. Citrin, who heads the company's media and technology practice. For Citrin, who co-wrote the new-leader guide *You're in Charge—Now What?* with fellow kingmaker Thomas J. Neff, onboarding can be as simple as giving a client a copy of his book and sharing insights over a leisurely breakfast. Whether it's for a couple hours or a couple months, with a coach or without, a serious head start is something top executives really need when they enter a new job these days. “There's so little time to make an impact,” says Citrin. ■

PLAYBOOK BEST-PRACTICE IDEAS

From 0 to 60 in 100 Days

Don't plan on hiring an “onboarding” specialist? Here are ideas for a great start from consultants who help senior executives switch into new jobs:

NEVER WAIT FOR DAY ONE

Getting started before your job officially begins can help make the first day feel more like the 15th. Hold one-on-one meetings with key reports and customers, create a strategic agenda for the first 100 days, and carefully study the company and its financials.

UNEARTH NEW STORIES

In those early meetings, ferret out lesser-known anecdotes about the new company you can share when trying to illustrate a point. Telling tales about your former company will only alienate your new colleagues.

THINK IN THREES

It's easy for new leaders to get overwhelmed by all the goals they set—and confuse people in the process. Three broad themes, says Spencer Stuart recruiter James Citrin, are easy for people to remember, and help clarify and organize priorities.

FIND YOUR “SHADOW BOARD”

New leaders should quickly ascertain who the people are that their boss will turn to for perspective on them. Fail to impress those people, and “they can bury you,” says onboarding consultant George Bradt.

MAP OUT QUICK WINS

Don't plan on a honeymoon. Early on, come up with a few important but easy-to-reach goals you can point out to the board, Wall Street, or employees as proof of what you or the organization can achieve.

prepare during the weeks preceding the new gig. By the time she started on Jan. 2, she had already had face-to-face meetings with all of her direct reports and had drafted an agenda for her first 100 days.

For some of the biggest search firms, onboarding is part of a trend toward providing broader leadership assessment, development, and coaching services. Since August, Korn/Ferry has acquired a leadership development and a coaching firm. Heidrick & Struggles, which explored acquiring PrimeGenesis in 2004, is building its own leadership development practice in-house and has begun consulting with HR departments to help them improve their onboarding process-

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Behind the Burst of Bourses

How new markets are moving in on the Old Guard

BY JOSEPH WEBER

WHILE THE NEW York Stock Exchange and NASDAQ chase after growth in London, Paris, and Mumbai, challenges are rising closer to home. BATS Trading Inc., a year-old Kansas City (Mo.) alternative market backed by Morgan Stanley, Lehman Brothers, and others, has been stealing stock trading volume as it moves toward becoming a full-fledged exchange. "We very much want to be the third U.S. equities market," says CEO David Cummings. Someday, the self-styled "computer geek" says, he'd like to surpass NASDAQ.

Lofty goals, sure. But only 10 months ago, the NYSE felt threatened enough by an upstart exchange, Chicago's Archipelago, to buy it. And by March, regulatory changes will force more stock trades to be routed to alternative markets if better prices are available there. The changes are "opening up a genuine opportunity to compete," says Thomas M. Joyce, a former director of Archipelago and NASDAQ who runs Knight Capital Group, parent of BATS rival Direct Edge.

BATS, formally known as Better Alternative Trading System, and Jersey City's Direct Edge do much of what exchanges do, matching buyers and sellers, but these electronic communications networks (ECNs) don't list stocks or police them. Together, they now handle over 400 million shares a day, more than 15% of NASDAQ's volume. BATS, with as many as 290 million shares a day, aims for 1 billion this year.

Many rivals are keen to take on the



CUMMINGS is willing to lose \$6 million this year to pick up trading share

titans. The newest entrant, slated to make its debut by early March, will be the CBSX, a stock exchange being launched by Chicago Board Options Exchange Inc. "Our low-cost operation allows us to be incredibly competitive," says CBSX President David Harris. Slated to be the nation's ninth stock exchange, the CBSX is backed by NYSE "specialist" firms such as LaBranche & Co., whose trading floor staffers see Chicago as a refuge if their NYSE business shrinks with the growth of electronic trading.

MAKING INROADS

CERTAINLY, VOLUMES are shifting. The Big Board's share in NYSE-listed stocks, for instance, slipped to 67.3% in December, nearly a percentage point less than November and down sharply from 76.5% a year earlier. NASDAQ picked up most of that. But reenergized exchanges in Boston, Chicago, New York, and Phila-

delphia, along with a new bourse started in September by the options-oriented International Securities Exchange Inc. in New York, are making some inroads, along with institutional trading outfits and the ECNs.

None is growing as fast as BATS, helped lately by a pricing special. Through January, BATS paid brokerage firms to send business, and Cummings is willing to lose \$6 million or so this year to pick up market share. When pricing goes back to normal, he could lose volume, but he bets "the majority is likely to stick." No one else, he figures, will be cheaper or quicker. NASDAQ does not comment on competitors; the NYSE says it will keep crafting services to remain competitive.

BATS gets a boost from three little-known trading firms—Chicago's Getco, New York's Lime Group, and his own company, Tradebot Systems—that deliver up to 100 million shares a day, he says. In addition, he's getting business from Lehman, Morgan Stanley, Credit Suisse, and Wedbush Morgan Securities, all financial backers. Wall Street wants places to turn to if the giants hike fees or are too slow to innovate. "Competition is always good," says David A. Herron, CEO of the Chicago Stock Exchange.

Ultimately, there won't be room for everyone. "The U.S. doesn't need nine exchanges if they don't differentiate themselves," says Joseph S. Rizzello, who heads Chicago's National Stock Exchange. For his part, Cummings says three or four major markets will emerge. Skeptics bet he'll sell BATS one day, but he insists he'd like to be a thorn in the side of the NASDAQ and the NYSE for a long time to come. ■

Spreading the Wealth

Average daily share volume in December

EXCHANGES	NYSE GROUP	2.15 billion
	NASDAQ	1.83 billion
	AMEX	55 million
	NATIONAL STOCK EXCH.	53 million
	CHICAGO STOCK EXCH.	42 million
	BOSTON EQUITIES EXCH.	10 million
	PHILA. STOCK EXCH.	3 million
	ISE STOCK EXCH.	NA
	ECNs*	
	BATS	105 million
	DIRECT EDGE	100 million

*Electronic communications networks
Data: Exchanges, ECNs

A Mutual Fund That Plays Politics

A new "Blue" fund invests in companies with ties to the Democrats. But will it beat the S&P?

BY RICHARD S. DUNHAM

ON A SNOWY DAY IN January, 2006, former Democratic National Committee Chairman Joseph J. Andrew trudged through the gray Manhattan slush to make his time-tested speech claiming that Democrats operate more innovative, socially responsible, and, yes, profitable companies.

Days after that speech to young Democratic business professionals, an Excel spreadsheet popped up in Andrew's e-mail at his Washington office at law firm Sonnenschein Nath & Rosenthal. Sent by a 29-year-old McKinsey & Co. consultant named Daniel de Faro Adamson, who attended the event, the e-mail showed that companies whose officers or political action committees gave to Democrats had outperformed major stock indexes over the past five years.

From this research Andrew and Adamson created a new mutual fund composed of companies that donate to Democrats and are deemed "socially progressive." The new fund family, named the Blue Fund in honor of the Democratic Party, was launched quietly on Oct. 17, 2006. In its first three months, its large-cap fund—whose holdings include Google, Starbucks, Lehman Brothers, and Costco Wholesale—topped the Standard & Poor's 500-stock index fund and gained 6.7%. The small-cap fund bested the Russell 2000 by rising 3.8%. Competition Policy Associates Inc., a bipartisan Washington-based consulting firm, found that over the past five years the large-cap fund would have outperformed the market by 13% per year; the small-cap fund would have beat the Russell 2000, but by less

than 1% a year. "Democratic companies do better than Republican companies in the market—period," Andrew claims.

The new venture, with just \$1 million in assets, is tiny by Wall Street standards. Many mutual fund companies aren't yet offering Blue; E*Trade Financial Corp. and Fidelity Investments made it available in early January.

It already has drawn skeptics, including fund executives who say the Blue Fund has a long way to go to prove its viability. Some critics caution against such socially responsible funds, which they say ask investors to "buy for love and not

money." "When companies start to rely on social responsibility, it's time to sell," says Steve Milloy, portfolio manager for the Free Enterprise Action Fund, which urges companies to resist liberal shareholder activism and has its own \$8.9 million portfolio of blue-chip stocks.

NO "RED" ALTERNATIVE

ALTHOUGH THE Social Investment Forum lists 201 funds that market themselves as socially responsible because they meet environmental, workforce diversity, and best-practice standards none takes contributions into account. No fund restricts itself to Republican companies. Yet of the 25 top corporate contributors to politicians over the past decade, all favor Republicans, according to data from the nonpartisan Center for Responsive Politics.

The socially conscious investing movement has not been especially lucrative. "Over a long stretch of time, there's not really a significant difference" in returns from those of traditional funds, says David Kathman, an analyst for Morningstar Inc., "but they do better or worse at different times." That's because the funds often invest heavily in technology, which has seen boom-and-bust cycles in the past decade, and little in energy, where values have soared lately.

Costco Chief Executive Jim Sinegal welcomes inclusion in the Blue Fund. But Sinegal notes that though he is a big Democratic donor, his company doesn't make political contributions. "We strongly believe you shouldn't be taking shareholders' money and putting it into political causes."

Socially conscious investing isn't especially lucrative

Andrew's business pedigree includes co-founding the Anson Group, a Carmel (Ind.) firm that provides business development services to medical startups and midsize companies. He was named DNC chair in 1999 by President

Bill Clinton to bring his business acumen to a party chronically in debt.

Now he's out to convince executives and Democrats to write checks for his new venture. "My goal," says Andrew, "is not simply to make a political statement but to build a serious financial institution." ■





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Andersen Was Never This Rewarding

Ex-CEO Berardino is improbably recast as an AIDS fighter at biotech startup Profectus

BY AMY BARRETT

IT HAD BEEN A LONG TIME since Joseph F. Berardino, the Andersen Worldwide CEO who saw his accounting firm collapse amid the Enron scandal, had been a student. Yet in 2004 he often found himself huddled over biology textbooks with tutor Shelley Phelan, an associate professor of biology at his alma mater, Fairfield University in Connecticut. Phelan says Berardino, despite the occasional distraction of his teacher's infant son, was "a very quick study."

That's good, because the 56-year-old Berardino has a whole lot riding on his new gig as a science guy. In late 2005 Berardino took over as CEO of Baltimore-based Profectus BioSciences Inc., a biotech startup trying to develop a vaccine and therapies for HIV. With 11 employees, Profectus was spun off from the Institute of Human Virology and was created to commercialize its work.

The institute was founded and is run by Dr. Robert C. Gallo, a scientist renowned for his pioneering work on HIV. Gallo has weathered storms of his own, including lawsuits and government inquiries into whether he overstated his role in identifying HIV and developing a blood test for it back in the 1980s. Gallo was exonerated.

On the vaccine front, Profectus is trying to target the HIV virus as it attempts to enter a cell, at which point the virus' myriad strains must all assume a similar shape. Profectus has partnered with drugmaker Wyeth to do this, and studies in animals are under way. Profectus' HIV therapies would aim to cool the body's overheated immune system after it's infected with HIV.

Berardino, who was not charged with wrongdoing by the government, plays down talk of redemption. "It was a wonderful 30-year career," he says of his

Andersen days. "I know this sounds but my family loves me, and that's a matters." Talk to those who know though, and you get the distinct Berardino would like to be associated with more than Andersen's imploded. Gallo says the board never thought about hiring Berardino: "I do believe underneath this he wants to show he's something good for humanity."

BUSINESS BRAIN

THAT'S CERTAINLY NOT what Berardino was thinking in 2003 when he met with Gallo at the request of a mutual friend. Berardino freely admits that at the time, AIDS "wasn't high on my list of social issues." But after talking with Gallo and his colleagues, Berardino was "blown away by what they were saying and the magnitude of this problem. The way this disease is destabilizing entire countries," he says. "It was a very interesting day." Berardino instantly saw he could be of use. For starters, Profectus needed assistance on the financial side and with governance issues, areas in which Berardino was confident he could contribute.

Berardino joined Profectus' board in 2004 and soon became its nonexecutive chair. Although still a science novice, he began thinking of moving into management. So he surveyed friends in the investment-capital and investment banking community. "I said: 'If I came to you for my advice [as head of a biotech company], would you laugh out loud or would you say this is interesting?'" Berardino recalls. "They said the latter." And Berardino he feels quite comfortable in the world of startups. "No, I don't have 85,000 people in 84 countries," he says. "But we're global, and this is a really big problem."

Berardino's role now is to bring business discipline to Profectus. Jeffrey Shulam, its chief operating officer, says Berardino has put more formal controls in place at the company, including budgeting procedures. "He knows where every dime is," says Gallo. Profectus has raised a total of \$5.25 million in venture capital over the last two and a half years. Berardino is spearheading

an additional fund-raising round to finance, among other things, the therapy work. That could involve partnerships with big pharmaceutical companies. Something Berardino contends he is suited to craft: "I am the world's expert in partnerships." No matter how he won that knowledge may be. ■

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Special Report



McDonald's



MICHAEL ARNDT

GRAPHS BY KELLY CULPEPPER

IT IS 3:36 A.M. THURSDAY AT MCDONALD'S IN GARNER, N.C., a bedroom community just beyond the city limits of Raleigh. Although the town's taverns closed more than an hour ago, the last clubgoers are straggling home. Their cars barrel by ones driven by waitresses, commercial cleaners, musicians, nurses, and computer analysts heading home from work. The McDonald's sign, posted high along a commercial strip of big-box stores and chain restaurants, is one of few still glowing.

Inside the McDonald's kitchen, Julia Diaz is mixing buttermilk dough by hand in a giant stainless steel bowl, while Silvia is grilling sausage patties and eggs for breakfast, which takes 24 minutes. Outside, at the drive-through window, Chavis is picking up a Premium Crispy Chicken Ranch BLT sandwich and a large order of fries. Chavis, 24, has just clocked out after 12 hours at a nearby food warehouse. He used to pick up an after-work snack at an all-night convenience store or diner. He swings by McDonald's at least five times a week for the hum sandwich combo meal or, if it's later, a McGriddle and a stack of hash browns. The food is a lot better at McDonald's, he adds, noting that the prices are cheaper and the brand is one he trusts. Says Chavis: "I was raised on McDonald's."

McDonald's went 24/7 in Garner in April, 2005, after a push by corporate headquarters to boost profits by extending store hours. Franchisee Fred Huebner had doubts at first. He doesn't



By focusing on the hours between traditional mealtimes, the fast-food giant is sizzling

more. By catering to the area's night owls and early birds on S. Highway 70, Huebner, who put on his first McDonald's in the town almost 35 years ago, figures he has increased his restaurant's revenue by 4.5%, or \$90,000, over a year. "There are no customers out there all times of the day," he says. "We have to be out there, too."

Over the course of an average day, 1,500 people—the equivalent of one out of every 16 people in the middle-class suburb of 24,095—come in to the Garner McDonald's. The clientele is every bit as diverse as the town's population. Old-timers joshing with one another over morning coffee. Office workers zipping from the pickup truck for breakfast behind the wheel. Repairmen on a midshift break. Mothers taking a breather while their preschoolers scamper to Play Place. Families ordering dinner in Spanish. And, in caratwenty-somethings after a night of carousing.

It wasn't always like this. When Ray Kroc launched his first McDonald's in 1955, McDonald's was a two-meal place, opening just after lunch and closing not long after dinner. It kept those hours





For all of its success at breakfast, management is confident that there's still plenty of room to grow in the morning. Why? Because it is still the meal that people in the U.S. are least likely to eat away from home. For every restaurant breakfast, the typical American orders 2.5 lunches and nearly 2 dinners, according to NPD Group. And new products attract new business. Since McDonald's rolled out a darker and stronger coffee last March, same-store sales at breakfast have increased 7.5% in the U.S., on a pace with Starbucks. To build on this momentum, the company is testing two more breakfast items: a Southern-style fried chicken biscuit and Newman's Own iced coffee.

A bigger breakthrough may come out of the company's experimental restaurant in Romeoville, Ill. Today the standard McDonald's kitchen has room for one built-in grill. As a result, restaurants have to stop serving breakfast in the late morning so crews can begin sizzling up burgers for the rest of the day. The company is working on a potential solution to this conundrum: a portable electric unit that would permit kitchens to serve breakfast all day long.

DINNER

5 p.m. to 8 p.m.

15% of the day's sales

With fewer families eating dinner at home, McD's sells more beef, chicken, salad greens, and apples than any other food company

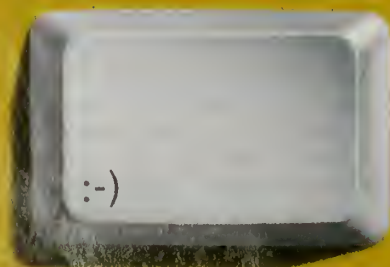
It's hard to believe that the pace in Garner could get much quicker. At the height of mealtime rushes, the place routinely serves 90 cars an hour, vs. 77 two years ago. Crew chief T

Marsh plucks hash browns from the fryer and steps back to the pickup window to hand another breakfast. He resets the wall-mounted timer that had been digitally ticking off 15 seconds since the order was placed. Sixty seconds. Store manager David Mardenborough who charts these times hour by hour, beams.

Maintaining McDonald's mastery of the morning will not be easy. Starbucks has begun making hot breakfast sandwiches and plans to offer them to 6,500 U.S. outlets by the end of 2008. At the same time, Wendy's is contemplating rolling out breakfast to its 6,300 restaurants in the U.S.

Canada. Dunkin' Brands Inc. has announced plans to triple its doughnut chain, to almost 15,000 shops, while adding new products like breakfast pizza to a line that already includes its knockoff of the Egg McMuffin.

Many restaurant analysts and consultants are betting McDonald's to win the breakfast battle. Even 22 years after introducing the Croissan'wich, they note, Burger King Holdings Inc. has never come close to matching McDonald's success.





lumes at breakfast. "The breakfast habit is the hardest habit to break," says CIBC's Glass. "We're promiscuous at lunch and dinner, but we tend to be monogamous at breakfast."

TERNOON: MIDDAY SNACKERS MAY be the least loyal. They enjoy temptations ranging from Starbucks Frappuccino and fruit smoothies at Jamba Juice to Big Macs at 7-Eleven. To shove its way to the front of the crowd, McDonald's has had no choice but to reinvent both its products and its store design.

The company's most important new enticement for these customers is its \$1.29 Snack Wrap, a strip of deep-fried chicken with cheese, lettuce, and a squirt of sauce tucked into a folded tortilla. Before it was introduced in August, McDonald's considered every detail in creating the wrap. Because so many consumers are on the go, the company needed something people could hold easily in one hand while gripping a steering wheel in the other.

Since salsas would drip, McDonald's opted for thicker ranch dressing. To further guard against spills, it went with a larger, 10-inch-diameter tortilla. The planning is paying off: The company has attributed strong same-store sales growth in the last 12 months in part to the Snack Wrap. To keep the momentum

going, the company is introducing a new version, with either fried or grilled chicken and honey-mustard dressing, in late January.

Don Williams got hooked on the Snack Wrap after his first one. It is 3:27 p.m. Thursday, and Williams, 54, a self-employed electrician, has stopped by in between jobs for something to tide him over until he can have dinner at 9 p.m., after his wife gets home from work. He ceased eating McDonald's burgers some time ago to cut down on his cholesterol. But while the Snack Wrap is hardly low-fat, he figures he eats one three times a week. "I like this little quick sandwich," he says. "It gives me enough energy to carry me for another two or three hours."

One reason McDonald's is creating crowd-pleasers again is that it has become much more rigorous in product development. New ideas are generated in the company's food studio in Oak Brook by a staff of three dozen chefs, food technicians, and market researchers. Potential new products get tried out first in one market for six weeks. The company doesn't just assess sales. It also monitors costs and margins and judges how easy a new product is to prepare by a crew that is constantly changing. (The annual

LATE NIGHT/ EARLY MORNING

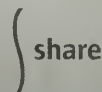
8 p.m. to 5 a.m.

16% of the
day's sales

Nearly two-thirds of its
business in the U.S. is done
at drive-through windows

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turnover among cooking crews companywide exceeds 100%, although it is about 70% for the Huebners.) If the concept passes muster, McDonald's expands its test cell to 800 to 1,000 restaurants in four to six markets.

Skinner and others say this wasn't standard operating procedure before the company embarked on its comeback in 2003. Back then the company was in all-out expansion mode, opening outlets somewhere in the world at the rate of one every 4½ hours. Ralph Alvarez, 51, McDonald's president and

it has different zones for different customers. There's the with its wall-mounted flat-screen TV, a Play Place for kids and a large high-top table in the middle of the store, behind a frosted glass partition. There are also decorative upgrades throughout, such as bronze sculptures and a fountain.

Their redesigned restaurant also boasts a McCafé, a separately demarcated space inside the store that sells espresso-based coffees and pastries. It is one of 45 McDonald's in U.S. testing specialty coffees. The McCafé in Garner does

have a separate seating area, but it has its own counter and a display case showing off baskets of muffins and pastries of desserts, such as \$2.50 tuxedo brownies and cheesecake at \$3 a slice. In addition to \$3.10 cups of latte and cappuccino, the Garner McCafé offers wraps and smoothies.

Kim Borum is impressed by the restaurant's new design touches. It is 12:45 p.m., and she is leaving after joining her husband, Bennie, for lunch. The restaurant has always been conveniently located for the Borums, but she says they now eat at McDonald's two or three times a week. "The ambience of a place makes a big difference in how people feel about it," she says. "If you walk into a place and you see that it's decorated from 1975, the first thing you're going

to think is old. And that's a bad thing to think about food."

THE McPLAYBOOK



Now That's Fast Food

To pump up business 24/7, McDonald's has sped up its new-product introductions. Here's its secret recipe:

Make it easy to eat

McDonald's does more than half its business at drive-through windows. That means it needs snacks and meals that can be held in one hand while the other is on the steering wheel.

Make it quick

It's called fast food for a reason. McDonald's tests all new products for cooking times so customers don't have to wait even a second longer than absolutely necessary.

Make it easy to prepare

McDonald's restaurant crews turn over entirely within a year, on average. To maintain consistency amid this churn, tasks must be simple to learn and repeat.

Make what the customers want

McDonald's prowls the market for new products and then spends months in carefully monitored field tests to ensure that people will buy its new concoctions.

chief operating officer, recalls spending six to seven days of his 20-workday month on real estate. That left scant time for things like consumer research. Little surprise that many new products bombed. Case in point: the McShaker salad. Introduced in 1999, it came in a large plastic cup designed to fit a car's cupholder. Problem: Nobody could figure out how to eat a salad while driving. "We were more willy-nilly then," says Skinner. "The attitude was, we'll make it and they'll buy it."

Today the company is adding just 50 to 100 sites a year in the U.S. The shift has freed up billions of dollars in capital, which has enabled McDonald's to quadruple its dividend to \$1.2 billion over the past four years, ramp up its share buybacks, and hand out generous subsidies to its 2,400 franchisees to refurbish their stores. Since 2003 the chain has remodeled more than 3,000 sites. Now it plans to convert every location over the next 20 years from its 1980s mansard roof design to a more upscale exterior of earth-red brick and glass accented by a yellow swoosh at the roofline. These new stores could cost up to \$1.5 million apiece to build. To help franchisees, the company has agreed to chip in as much as \$600,000 per site.

Fred Huebner and his wife, Doris, redid the Garner store last year. Before, the dining room had been a single space, with fluorescent lights and hard-backed chairs and booths. Today

LATE NIGHT: THE HUEBNEERS are a genuine McDonald's success story. The couple, who met at McDonald's in 1977, paid \$400,000 for their first store in 1986. They bought their 12th store for \$1.8 million in September. Their business now generates more than \$25 million in annual revenue. They employ 70 people, including their sons, John and Frederick.

Despite their track record, the Huebners were hesitant about staying open all night. McDonald's had begun urging U.S. franchisees to extend their store hours in 2003. It offered \$1,000 per site to cover in-store promotional signs and local advertising if they went all the way and never closed. To draw up overnight traffic, headquarters also started dispatching tricked-out RVs to concerts, sports events, and bars to pit twenty-somethings with coupons and contests.

Two months after they decided to go round-the-clock with the drive-through service, Fred Huebner says, his doubt seemed confirmed. Although the outlet already had an after-hours crew that stayed as late as 1:30 a.m. to clean up after another that clocked in at 4:30 a.m. to set up for the new day, the extra hours boosted expenses for payroll and utilities. Even

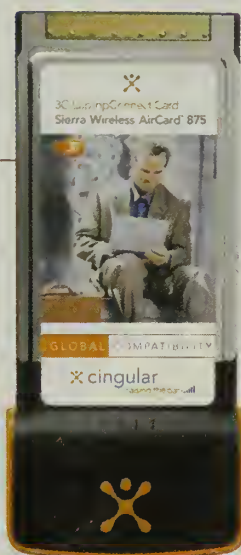


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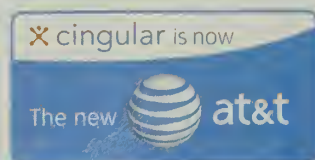


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with a limited menu, the store was losing money on the overnight shift. But by the third month the new shift was turning a profit. These days an extra 50 to 60 cars, on average, pull into the drive-through lane every night. The Huebners believe the move probably has helped increase traffic during “shoulder hours,” too, since customers no longer wonder whether McDonald’s is open.

Elizabeth Williams, a pharmacy technician at a CVS store, is a new McDonald’s regular. It is 2:53 a.m., and she is returning home from a bar in Raleigh. A few times a week, before she goes to bed, she says, she stops after an evening out for her nighttime snack: a Premium Grilled Chicken Ranch BLT sandwich, medium fries, and a 32-ounce sweet tea.

Amid the barhoppers, there are also people like Steve Smith. A 45-year-old truck driver, Smith pulls in at 3:15 a.m., on his way to work, for a Quarter Pounder combo meal. He has been eating at McDonald’s since he was a kid, and he still comes in at least three times a week. Before the restaurant was open all night, he says, his options were pretty limited: “I’d eat cereal at the house.”

The success in Garner’s overnight business speaks volumes about McDonald’s role today. Although it is well known for the

sameness of its food and restaurants, McDonald’s is really a lot of different restaurants that cater to a lot of different people. When Huebner started working at McDonald’s, there was no breakfast, no Big Mac and no drive-through window, either. Now since the Huebners’ dozen McDonald’s are open 24/7, and the rest are open at least 18 hours a day. “Ten years ago we saw every customer as a transaction count,” Huebner recalls, “not as a person who needed to use the restaurant in a different way.” ■

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INSIDE THE WORLD’S FAVORITE FAST-FOOD COMPANY

ONLINE: What do you know? Take an online quiz on McNumbers big and small.

ONLINE: Mayor McCheese speaks. A Q&A with CEO James Skinner.

PODCAST: The story behind the story. Executive Editor John Byrne interviews Senior Writer Michael Arndt.

TELEVISION: Mac on the tube. For more on McDonald’s moves to pump up its business 24/7, watch our weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com to see video clips, or type in your Zip Code to find when and where it airs in your area.

Meet You for Lunch, Mom. Usual Place

ANGIE STALLINGS IS BUSY, busy, busy. When she is not working at Smith Elementary School in Garner, N.C., the first-grade teacher is driving her 13-year-old daughter, Sarah, to and from cheerleading and basketball practice, or shuttling back and forth for evening meetings at the Capital Church, or simply running errands. Constantly pressed for time, Stallings says, she brings Sarah to McDonald’s at least three times a week for a quick meal.

In restaurant parlance, Stallings is a “heavy user.” At McDonald’s, the average customer comes in once every week, and 95% of the nation stops in over the course of a year, according to surveys by BIGresearch of Worthington, Ohio, and other consumer research outfits. But it is the heavy user—someone who frequents the same fast-food chain twice a week or more—who really accounts for the steady rise in sales and profit for McDonald’s.

In general, the heavy fast-food user is a single man in his mid-20s who has a professional job that pays above-average wages. That’s true at McDonald’s, too. But the chain’s heavy-user population also includes an unusually high number of married women with two or more



young kids at home, professional jobs, and middle-class household incomes. Moms, in other words.

Stallings, 40, says that when she was growing up in Garner, she didn’t often go to McDonald’s. There weren’t many around. Today, there’s one a mile from her job. She

STEADY DATE
Sarah and Angie hit McDonald’s at least three times a week

became a regular three years ago, when she started teaching and Sarah’s schedule filled up, leaving her little time to prepare meals. Usually the pair get food to go from the drive-through lane, but sometimes her husband, Bill, 43, a police officer at the state capitol in Raleigh, joins them inside for a sit-down meal. They eat at another fast-food chain two times a week as well.

For breakfast, they typically have a specialty coffee and maybe a muffin from the restaurant’s McCafé section before middle school starts at 7:30 a.m. At lunch or dinner, they mix things up. Often they get double cheeseburgers or McChicken sandwiches from the Dollar Menu, or the \$1.29 Snack Wrap. But lately, Stallings says, she has been ordering more salads, a product that McDonald’s added in 2003 specifically for mothers. While Sarah drinks sodas, Stallings also has switched to bottled water. “I do try to make healthy choices,” she says.

Nonetheless, Stallings says weight is an issue for both her and her husband. Has she thought about cutting back on McDonald’s food? Yes, she says, but she’s decided against it. She eats vegetables and fruits at home. She also started exercising two months ago, walking at least one mile four times a week. Judging by her friends and family, she says, she doesn’t think they eat more fast food than everyone else. Besides, she doesn’t have a spare moment to do more cooking. “The convenience factor is the big selling point, with the busy lifestyle we have.”

—By Michael Arndt



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How Bob Iger Unchained Disney

By shunning the limelight, seeking consensus, and giving executives room to run, he has radically transformed a troubled culture

BY RONALD GROVER

FOR THE PAST YEAR, THE media-entertainment complex (aka Hollywood) has provided riveting theater. Summary firings at Viacom. A quixotic bid to break up Time Warner. News Corp.'s O.J. Simpson moment. But one entertainment colossus has been remarkably peaceful—so much so it's easy to forget that not long ago this place was a snake pit of warring egos, board intrigue, and assorted skulduggery.

That institution, of course, is Walt Disney Co. Not only has peace broken out since Robert A. Iger settled into Michael D. Eisner's throne at the pseudo-Tuscan headquarters in Burbank, Calif., but the Mouse House also has been racking up enviable numbers. It's posting record earnings, and the stock price has been defying gravity like Disneyland's Big Thunder Mountain Railroad.

So the Oscar for Disney's turnaround goes to...Bob Iger. No, wait, to Michael Eisner. No, both.

We'll explain.

Ignore for the moment the splash Iger made last year when he repaired relations with Steve Jobs and took control of Pixar, the Apple Inc. founder's animation hit factory. Most of the good news at Disney since Iger's ascension—the resurrection of ABC, the \$2 billion *Pirates of the Caribbean* franchise, rising attendance

at Disney's U.S. theme parks—are the payoff of plans laid during the Eisner era. And though Iger was deeply involved in the revival at ABC, he is the first to give his predecessor credit: "It was because of Michael that I was able to hit the ground running," he says.

On the other hand, those record profits deserve a second look. Yes, net income soared 33% in fiscal 2006, to \$3.4 billion, while revenues climbed 7%, to \$34.3 billion. But Disney had a one-of-a-kind year in 2006, with two box-office smashes in *Cars* and *Pirates of the Caribbean: Dead Man's Chest* that by themselves gave Disney earnings a huge pop. That sets the

How's **Disney** Doing?

The stock is up 51% since Iger took over 15 months ago, vs. 29% for other media companies. But analysts say earnings, which soared 33% in fiscal 2006, will grow just 12% this year, vs. 24% for the sector.

Data: Bloomberg Financial Markets, Thomson Investors Network

TIM BOWER





bar high for Disney this year. While another *Pirates* film is due out this summer, along with Pixar's *Ratatouille*, Thomson Financial projects net income growth in 2007 of 12%, vs. 24% for the media sector as a whole.

To buffer the company against the hit-and-miss vagaries of the movie business, Iger will need to complete an ongoing resuscitation of the Paris and Hong Kong theme parks, keep ABC's momentum going, and encourage the Pixar team to make more than one film a year. He must also make Disney nimbler and capable of moving quickly to seize the digital day.

CRONKITE WANNABE

IT'S ON THAT FINAL challenge that Iger has made the most progress. Behind the scenes he has upended Eisner's centrally planned company, hacking away at the bureaucracy and unshackling a group of veteran executives to plot their own courses. Putting Disney movies and ABC shows on the iPod is not just groundbreaking. It's a reflection of a faster-moving and more aggressive Disney. In an e-mail, Eisner, who declined to comment on his record as CEO, had this to say about his successor's performance: "Bob Iger and the entire management team have done a great job in the last year. They are making the right moves at the right times."

Iger, who turns 56 on Feb. 10, is a guy who says things like: "The story shouldn't be about me. It's about the team." Sounds like the false modesty of a media-trained CEO, no? But Iger really does prefer to hover in the background, letting the limelight stream over his lieutenants. He rules by consensus, not fiat. And rather than heaving Eisner's people overboard just because he could, Iger has kept the team largely intact.

Next to Eisner, Iger is bland, a scripted CEO who never shoots from the hip. Colleagues say they don't know much about Iger's personal life except that he's a basketball nut. And while Iger isn't without the vision thing, no one would call him a big strategic thinker. But by surrounding himself with smart people, including Jobs and the Pixar crew, and letting them get on with it, Iger has recreated a can-do culture at Disney.

Iger, in short, is the Un-Eisner. He represents the new buttoned-down Hollywood—the anti-mogul in an industry where egos blot out the sunshine. "Bob lets [the person] who can handle the job get it done," says Jobs, who sits on the board and is Disney's single largest shareholder. "It's not [about grabbing]

headlines. That's rare in that town."

Most Hollywood bigs either have mogul DNA (Rupert Murdoch) or lust for power and riches from Day One (Eisner). But Robert Iger wanted to be Walter Cronkite. Growing up on Long Island in Oceanside, N.Y., the son of a marketing executive father and librarian mother, Iger got the journalism bug early as sports editor of his high school newspaper. By 1972 a shaggy-haired Iger was hosting Ithaca College's ICB-TV show *Campus Probe*, tackling such breaking news as the school's new credit union. But the networks never came calling, and Iger accepted a job as a weatherman at a local TV station.

He might still be in Ithaca, N.Y., today had he not signed on as a schedule coordinator for ABC Sports in 1974. Soon after



A GOOD YEAR (clockwise) Despite slow growth in Hong Kong, a *Pirates* sequel and Pixar's *Cars* spiked earnings

joining the network, Iger met the surrogate father who helped launch his career and instilled in him the management ethos he follows to this day. That man was Thomas S. Murphy, founder of ABC's then-parent, CapCities. Murphy, now 80 and retired from the Disney board, was a legendary figure who gave young talent the freedom to experiment.

Iger calls it the Tom Murphy School of Management. "You put good people in jobs and give them room to run," he says. "You involve yourself in a responsible way, but not to the point where you are usurping their authority. I don't have the time or concentration—and you could argue maybe even the talent—to do that."

Disney acquired CapCities in 1996, and Iger, by then Murphy's heir apparent, found himself working for an entirely different species of boss. Eisner was everything Murphy wasn't: micromanaging, imperious, bullying

Eisner rarely demonstrated much admiration for Iger, but he valued his diplomatic skills. In 2000, Iger became Disney's president, and it wasn't long before Eisner was dispatching him on thorny missions requiring the common touch Eisner seemed incapable of. When ABC tried and failed to steal David Letterman from CBS to fill Ted Koppel's late-night slot, Iger was the one who sweet-talked

Koppel into sticking around. When dissident board members Roy E. Disney and Stanley P. Gold staged an anti-Eisner rally at Disney's 2005 annual meeting, Eisner sent Iger to talk to the press.

And when Miramax Film founder Harvey Weinstein was battling Eisner over the terms of his divorce from Disney, Iger stepped in to "get the talks over some rough spots," recalls William Morris Agency CEO Jim Wiatt, who helped broker the deal. "Bob kept the two sides talking when I thought they'd had just about enough of each other."

To this day, Iger won't speak ill of Eisner. "I think fondly of Michael. I learned a lot from him," he says. "In a way, he founded the modern Walt Disney."

What Iger tactfully leaves unsaid is that during the final years of Eisner's otherwise brilliant two-decade run, Disney lost its animating spirit. To say the culture was poisonous doesn't begin to capture the company's dysfunction. Eisner left behind a place where division chiefs were afraid to make decisions—the last thing the company needed when such rivals as News Corp. and Viacom Inc. were boldly staking out territory on the Web.

Iger recognized that the problem wasn't the people running the show. It was the work environment—and he set about changing it. One of the first things Iger did was make the Monday morning meetings less autocratic. Where Eisner held court, Iger encourages a conversation. Even his office is more inviting. Once he went the drabness of the Eisner years. He came airiness, family photos, and a big store Indian Iger found in the basement of the ABC building in New York. Iger hangs his suit jacket on it.

To encourage his executives to drop the heavy door, Iger also installed a door to a more heavily trafficked hallway. He moved studio chairs

How to Follow A Powerful Chief Executive

It's never easy, but James M. Citrin, a senior director at executive search firm Spencer Stuart and co-author of *You're in Charge—Now What?*, offers four guidelines:



BE YOUR OWN PERSON

Don't try to be someone you're not. As Jeff Immelt said shortly after becoming General Electric CEO: "I'd never try to 'out-Jack' Jack." Also, introduce (or reintroduce) yourself to the company and let them know who you are and what you want to accomplish.

IT'S NOT ABOUT YOU

It's about the company and the people who work there, the customers you serve, and the investors who are looking for an attractive return. Give credit to others for successes and use "we," not "I"—except when shouldering blame.

ESTABLISH THREE POWERFUL THEMES

Make them straightforward and use them consistently and relentlessly. The three themes (two seem incomplete, and people won't remember four) need to be sufficiently specific to be meaningful, yet general enough to serve as organizing principles.

NEVER SPEAK ILL OF YOUR PREDECESSOR

This is especially true with a powerful leader. Some colleagues will be nostalgic for the ex-CEO. Preserving a sense of continuity and demonstrating genuine respect for the prior regime will establish you as a classy and seasoned leader.

hard Cook up from the second floor to sixth, where Iger has his office. And he de a point of visiting the troops—for ample spending half a day at Buena Vista Games Inc. talking to game develop- in town for a brainstorming session. These are guys who'll go back to England wherever with a sense that their ideas "getting heard," says game unit chief tham Hopper. "That's tremendously powering to a creative person."

Iger has also reached out to former money people who can help him chart new strategic direction. One regu- dinner companion is former studio ef Jeffrey Katzenberg. Disney recently eed to air a *Shrek* Christmas special oduced by Katzenberg's DreamWorks imation. Iger has also made peace h Stanley Gold and Roy Disney, invit- the latter back onto the board in an eritus role and as a consultant. "He's

got the company working like a team again," says Gold, once an Iger critic. "It's very impressive."

'WHERE'S MY WOW?'

IF EISNER STRUGGLED to rise above the petty and personal, Iger sees the big picture. Almost immediately he shunted aside the top strategic planner, Peter Murphy, who had come to be regarded as Eisner's top cop. Then Iger turned around and paid Murphy nearly a million dollars to stick around for another year. Why? Because Murphy was Disney's key negotiator in a three-year battle to get cable giant Comcast Corp. to pay higher fees to carry Disney's ESPN sports channel.

Eisner never got over Comcast's hostile takeover bid in 2004, and the talks often bogged down. Iger figured Murphy was best positioned to get the job done. "You

could see the difference in [Murphy's] body language," says Comcast President Stephen B. Burke. "He was free to make a deal without worrying about getting grief from Michael." In the end, Comcast agreed to pay an estimated \$70 million more a year in fees, and Disney won a lucrative deal to provide movies and TV shows for Comcast's video-on-demand service. Murphy, who declined to comment on his departure, has left the company.

Iger brings almost preternatural energy to the job. Every morning at 4:30 a personal trainer puts him through his paces at the Brentwood mansion (formerly owned by Michelle Pfeiffer and her TV writer husband, David E. Kelley) Iger shares with his wife, newscaster Willow Bay, and their two sons. By 6:45, Iger is at his desk, talking to New York.

It's what Iger doesn't do with his energy that is most telling. He doesn't



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dump on people's ideas. Eisner famously wrote: "Where's my wow?" on subordinates' proposals he didn't like. And where Eisner got involved in every aspect of the creative process, from the color of the carpets at the theme park hotels to Tuesday morning script sessions, Iger lets his people take the lead.

DISCREET AND NIMBLE

ABC CHIEF ANNE SWEENEY says Iger, having agreed with Jobs to put ABC shows on the iPod, turned over the details to her. She quickly understood that the intensely secretive Jobs wanted as few people as possible to know what was going on. Only five Disney people, including Iger, were involved in the negotiations; the deal was sealed in three days. Under Eisner a team of Disney lawyers and executives would nitpick over the details for weeks.

Studio chief Cook has newfound freedom. Iger almost never attends script meetings. And during the Pixar negotiations, Iger allowed Cook to represent Disney. The CEO came in only at the end to close the deal, meeting with Jobs and having dinner with Pixar creative guru John Lasseter at his Sonoma Valley home.

Eisner's departure also allowed Cook to go ahead with an Iger plan to cut in half the number of live-action movies the studio makes each year and do mostly family-friendly fare that meshes better with the theme parks and the Disney Channel.

Nowhere has Iger given up more control than at Disney's animation unit. That's amazing given that the Mouse House was built on animation. In a good year it provides as much as one-third of the studio's profits. But with Disney animators turning out a steady stream of clunkers, Iger has given Jobs's Pixar team carte blanche. With Lasseter installed as Disney's new chief creative officer, the newcomers laid off 160 people and reassigned executives. Last year, Lasseter and former Pixar President Ed Catmull, who is now president of Disney Animation, delayed the Christmas release of Disney's *Meet the Robinsons* movie to rework it. Now it will be released in March.

Jobs says Pixar's management control of the Disney animation unit was key to selling Iger his company. "I wasn't sure I could get Ed and John to come to Disney unless they had that control," says Jobs. "Bob said: 'Dynamite it if you have to.' Thankfully, we saw plenty we liked."

Iger's hands-off M.O. has its limits. The Pixar people decided, for example, not to release a Tinker Bell animated DVD later this year because they wanted time to make it better, even though the release

had been timed to coincide with a Disney promotion of toys based on characters. And the quality-first attitude of the Pixarites, which could generate bigger box office, might also mean fewer animated movies each year. They're big on sequels, either. That means opportunity for tie-ins with merchandise, the theme parks, Broadway plays.

Then there's the ESPN-branded phone. Round-the-clock delivery of sports trivia and game scores supposed to be manly sports nuts. The phone flopped, forcing Disney to take a \$30 million write-down. Iger waxes philosophical. "I don't criticize them for taking risks," says He figures ESPN

learned from the experience and Iger has more insight than its rivals into how best to put content on cell phones.

During the Eisner years, Disney's digital strategy faltered. Iger seems determined to make up for lost time—even if it means more ESPN-style flops. A technophile, Iger travels with two iPods and is constantly road-testing the latest gizmo. His decision to acquire Pixar and let Apple put ABC shows and Disney movies on the iPod galvanized the company and sent a message to its managers. The new boss was willing to take risks to drag Disney into the digital age. "Wow. Now I get it," recalls Disney Internet Group chief Steve Wadsworth. "The company is ready to roll."

Nowhere has Iger given up more control than at the animation division



EISNER
Free to do deals his way

SECOND ACTS

Going Digital With A Billion-Dollar Bankroll

More than a year after leaving Walt Disney Co., former Chairman and CEO Michael D. Eisner is once again doing what he likes best: making deals.

An extremely wealthy man thanks to the more than \$1 billion in salary, bonuses, and stock options he raked in during his 21 years as Head Mouse, Eisner, 64, is quietly building a private media company. Freed from the prying eyes of shareholders and board members, Eisner can

be Eisner—inking deals, acting snarky, and well, being master of his own universe.

That universe is the five-person Tornar staffed by an ex-Disney MBA and a couple secretaries and dealmakers. Operating from a Beverly Hills address, Eisner has gone into new media, plunking down an undisclosed sum to buy Team Baby Entertainment, which makes report-themed DVDs for children, and taking a stake in Veoh Networks Inc., an ad-supported YouTube-like consumer-generated video s

BIO BOX BOB IGER



BORN Feb. 10, 1951

THE INNER HAM Voted "most enthusiastic" at New York's Oceanside High School, Iger was sports editor for the newspaper, the radio voice of the varsity sports teams, and Francis Nurse in *The Crucible*.

THE NEXT CRONKITE After the "thrill" of pitching story ideas to Ithaca College professor and *Twilight* creator Rod Serling, Iger hoped to translate his BS in communications into a reporter gig. Instead, he was a TV weatherman in Ithaca, N.Y., before heading to BC Sports.

HE BIG BREAK Iger caught CapCities/ABC CEO Thomas Murphy's eye after juggling the program schedule to avoid disaster during the snow-poor 1988 Winter Olympics in Calgary.

THE DIGITAL CEO A technophile with multiple iPods, he wants content from Disney, ABC, and ESPN available to consumers 24/7 on the Web, phones, DVDs, everywhere. And he doesn't mind ruffling feathers to do it: He angered theater owners when he said DVD release dates should be closer to their openings on the big screen. And Blockbuster and Target initially threw fits when he put movies on Apple's iTunes.

THE PRIVATE BOB A father of four, Iger hangs out in Brentwood, Calif., with his second wife, newscaster Willow Bay, and their two young sons. Last year they paid \$19 million for a two-acre property with a 7,500-square-foot house that was previously owned by TV writer David Kelley and his actress wife, Michelle Pfeiffer. A fitness fanatic, Iger works out with a trainer at 4:30 each morning and takes bike rides with News Corp. President Peter Chernin.



ON THE TOWN
Willow
and Bob

ABC chief Sweeney recalls Iger dropping by her office not long after he took over to talk about the network's future. He suggested coming up with an ABC where viewers could get TV shows whenever they want. "We had a really interesting discussion of how you'd contact your own [online] network," says Sweeney. "Bob's parting words were: 'Go it.'" A month later he announced the initiative at Disney's annual meeting. If one thing separates Iger from other media moguls like Rupert Murdoch and

Sumner M. Redstone, it's his belief that he doesn't need to go out and acquire a MySpace.com or YouTube Inc. While he hasn't ruled out buying an online property, Iger says he has the right content and world-class brands—Disney, ESPN, ABC—to lure eyeballs.

The rollout in coming weeks of a reimagined Disney.com is central to Iger's plan to boost the company's online fortunes. The reconfigured site, which draws 21 million unique visitors each month, now features social networking

and streamed TV shows aimed at young kids—another way to capitalize on that family vibe. The hope is that the site will get visitors to stay longer, allowing Disney to surpass the \$700 million in digital revenues it projects for this year.

Ultimately, Iger wants to go directly to consumers on the Web, supplementing the company's existing deals with cable and satellite providers. "Why not be there ourselves?" he says. It's a question Iger will continue to wrestle with as he remakes Disney. ■

aims 4 million unique monthly users. Iger hasn't been shy about using his x or hardball negotiating tactics to give investments a boost. He got Regis Philbin and other buddies to lend their voices to baby DVDs. And shortly after investing in, which also has such backers as Warner Inc., Eisner tracked down Jenner, a former Disney partner in *Survivor*, and persuaded him to put its reality sightings on Veoh's new broadband Channel.

Iger also hopes to find the next crop of Spielberg among the amateurs putting videos up on the site and get real jobs directing movies in Hollywood. Iger went to United Talent Agency and deal whereby Veoh would create a YouTube site where aspiring filmmakers post their work in the hopes that the network will pick them up as clients. The

kicker for Veoh is that it will get a healthy piece of the site's ad revenues thanks to some muscular deal-making by Eisner, "Hollywood people negotiate tough," marvels Veoh Chief Executive Dmitry Shapiro.

Eisner had originally planned to do deals with Disney. The Team Baby buy, for instance, would have been a perfect fit for his former company. After his resignation, Eisner agreed to sit on the Disney board and then realized that potential conflicts of interest would crimp his freedom. So he left the board and went out on his own. His people say more deals are coming, but Eisner is keeping mum.

When not tinkering with his investments, Eisner hosts his MSNBC show, *Conversations with Michael Eisner*. It's one of the business channel's lower-rated offerings; despite his fast-thinking and unscripted Hollywood persona, Eisner is no Oprah or Charlie Rose. Yes, he managed to get a rise out of Sumner

M. Redstone when he suggested that the octogenarian chairman of Viacom Inc. hand the CEO reins to his daughter, Shari E. Redstone, president of National Amusements Inc. But skins don't get much thinner than Redstone's, so that was no coup.

Eisner has also become a fixture on the conference tour, interviewing IAC/Interactive CEO Barry Diller in Beverly Hills recently and Sony CEO Howard Stringer at the annual Sun Valley summer gabfest hosted by Allen & Co. And like many rich or famous men with lots of time on their hands, he travels the globe making speeches at about \$100,000 a pop. Mostly he uses his private jet. But sometimes he flies commercial, his ESPN cap worn low in a half-hearted attempt to conceal his identity. One of his crowd-pleasing addresses: *Leadership: Succeeding by Failing and Other Paradoxes*.

—Ronald Grover



GREG BOERBOOM RAISES 37,000 PIGS a year on his farm in Marshall, Minn. Those hogs eat a lot of corn—10 bushels each from weaning to sale. In past years he has bought feed for about \$2 a bushel. But since late summer, average corn prices have leapt to nearly \$4 a bushel.

To reduce feed costs, he sells his pigs before they reach the normal 275 pounds, and keeps them warmer so they don't devour more food fighting off the cold. Still, Boerboom hopes just to break even. "It's been a pretty tight squeeze on pork producers," he says. "The next eight months will be really tough."

The spike in the price of corn that's hurting Boerboom and other pork producers isn't caused by any big dip in the overall supply. In the U.S., last year's harvest was 10.5 billion bushels, the third-largest crop ever. But instead of going into the maws of pigs or cattle or people, an increasing slice of that supply

Food **vs.** Fuel

As energy demands devour crops once meant for sustenance, the economics of agriculture are being rewritten.

**BY JOHN CAREY AND
ADRIENNE CARTER**

is being transformed into fuel for cars. The roughly 5 billion gallons of ethanol made in 2006 by 112 U.S. plants consumed nearly one-fifth of the corn crop. If all the scores of factories under construction or planned go into operation, fuel will gobble up no less than half of the entire corn harvest by 2008.

Corn is caught in a tug-of-war between ethanol plants and food, one of the first signs of a coming agricultural transformation and a global economic shift. Ever since our ancestors in the Fertile Crescent first figured out how to grow grains, crops have been used mainly to feed people and livestock. But now that's changing in response to the high price of oil, the cost in lives and dollars of ensuring a supply of petroleum imports, and limits on climate-warming emissions of fossil fuels. Farms are energy's great green hope. "Economics, national security, and greenhouse gases have created a perfect storm of interest," says John Pierce, vice-president for bio-based technology at DuPont, which is making fuel and chemicals from plants.

Indeed, a massive expansion of biofuels is the one policy that has support from Democrats and Republicans and from both ends of Pennsylvania Avenue. In his Jan. 23 State of the Union address, President George W. Bush called for 35 billion gallons of renewable fuels per year within 10 years, enough to replace 15% of gasoline burned in American cars and trucks. Congress is considering measures that would require 60 billion gallons by

ILLUSTRATION BY ROGER KENNY WITH PHOTO BY JONATHAN KANTOR/GETTY IMAGES



The Global Consequences of Using Crops for Fuel



HIGHER COSTS ON THE HOOF

With nearly 20% of the U.S. corn crop already being turned into ethanol, prices have doubled since last summer. That means higher feed costs for chickens, pigs, and cattle—and higher prices for meat and poultry at the grocery store.



FLOWER FUEL FOR CARS AND TRUCKS

Fields of rapeseed in Germany are helping Europe move toward its goal of making 5.75% of diesel fuel from plants. Growing demand for the plant's oil is pushing up prices for the crop's other uses, cooking oil and protein meal.



FORESTS CUT TO MAKE ROOM FOR FUEL CROPS

The air across Indonesia and Malaysia was thick with smoke last fall as farmers cleared land for oil palm plantations. The two countries are building scores of factories to turn the oil from the plants into biodiesel for export.

2030. And the fervor for greener fuels isn't just a U.S. phenomenon. Europe is requiring that 5.75% of diesel fuel come from plants by 2010, while Japan and others line up contracts to buy biofuels to reduce their greenhouse gas emissions.

New Landscape

THE CONSEQUENCES, while still uncertain, are impossible to ignore. According to the most optimistic estimates, which involve a switch to still-unproven energy crops, replacing U.S. consumption of gasoline with biofuels would take at least 50 million more acres of American cropland. Some put the figure far higher. Meeting Bush's mandate with corn ethanol alone isn't even feasible, because it would mean an additional 80 million acres of corn. Eliminating gasoline entirely could require more than double today's 430 million acres of cropland, by some calculations. Bioenergy threatens to eclipse food, livestock feed, and all other uses "as the major driver of American agriculture," testified Iowa farmer John Sellers at a recent Senate Agriculture Committee hearing.

Already, the growing demand for biofuels is bringing major expansions. Last fall, Singapore was enveloped in choking haze from forest fires set to clear land to plant oil palms. The palms will supply 90 biodiesel plants under construction in Malaysia

and Indonesia. Biofuels are "a key engine of growth," says Indonesian President Susilo Bambang Yudhoyono. If the bioenergy boom continues, Agriculture Dept. chief economist Keith Collins foresees boosts in sugar cane and other crops everywhere from Thailand and Australia to Brazil and Central America. It starts to change the landscape of agriculture," he says.

Whether this is good or bad is a matter of intense debate. One extreme is Lester Brown, president of the Earth Policy Institute. He warns of a coming "epic competition between 800 million people with automobiles and the 2 billion poorest people and predicts that shortages and higher food prices will lead to starvation and urban riots. "I don't think the world is ready for this," he says. Dow Chemical Co., which is turning soybeans into foam for furniture and car seats, worries about rising demand. "There's only so much biologically based stuff around," says William F. Banholzer, corporate vice-president and chief technology officer. With chemical companies competing for fuel and food over the supply of certain crops, "it's not a very rosy picture," he says. Nor is the conversion of ecologically valuable forests to oil palm in Malaysia or sugar cane in Brazil. "We are we burning our forests to plant something that we have been told will be clean, environmentally friendly fuel?" asks S. Idris, chairman of environmental group Sahabat Alam Malay (Friends of the Earth). "This is technology gone mad."

In addition, biofuels are expected to bring a rare permanent

nge in farm economics. "People had grown accustomed \$2-per-bushel corn. That's not going to happen anymore," s Bob Dinneen, president of the Renewable Fuels Assn. her corn prices are already rippling though the economy, ng prices for soybeans and other crops, and products like fillas. Next could be meat, poultry, and even soft drinks. cken producers estimate that the industry's feed costs are eady up \$1.5 billion per year. "Ultimately, these increases l be passed on to consumers, and we could have a fairly matic inflation scenario for food costs," says William Lapp, sident of consultant Advanced Economic Solutions.

s all this really so bad? Pessimists, in fact, are a minority in ates about food vs. fuel. Lapp notes that food is now at its apest level, historically. "It'll be easier to pass on the food eases because we're spending a smaller portion of our disa- ble income on food than in the 1970s," he says. And some erts even argue that a boost in food prices could be beneficial Americans' health. A dou- ng of corn prices makes n syrup more expensive, ng the price of a bottle of a by 6¢, calculates David rris, vice-president of the titute for Local Self-Reli- e in Minneapolis. That

ght lead people to consume less. "If Americans reduce our ut of sugar, we could make 2 billion more gal. of ethanol and p overcome our obesity problem," he says.

And while grocery bills could rise modestly, higher agricultur- ommodity prices are a boon in many ways. Corn farmers are ing a rare period of prosperity, and the federal government etting a break. In 2006, Uncle Sam gave corn farmers \$8.8 ion in subsidies. Thanks to high corn prices, subsidies are ected to drop to \$2.1 billion in 2007. "All the price-dependent nding is getting wiped out," explains the USDA's Collins.

Higher incomes for farmers also mean healthier rural omies and more jobs in the U.S. and around the world. ntrary to Lester Brown's grim scenarios, "[biofuel] could be fesaver for Third World countries," argues Morris. "It can p keep farmers on the land without providing huge public osidies." Plus, crop-based fuels could shift the global bal- ce of power, as countries grow enough of their own fuel to ck back on imports from OPEC and other oil producers.

In the most optimistic scenarios, the world will move smooth-

ly to biofuels through increased farm acreage, higher yields, and new crops and technologies. "Don't underestimate the ability of U.S. and global agriculture to respond to higher prices," says Collins. Farmers already plan to seed 10 million more acres of corn this spring. Some even worry about overshooting demand. "There's an old saying that goes, 'Farmers will see a hole in supply and put a pile on top of it,'" jokes Illinois farmer Steve Pitstick, who's shifting most of his soybean field to corn.

Corn is just the first step. It's a lousy raw material for fuel because producing 10 gallons of ethanol consumes the energy equivalent of about 7 gallons of gasoline, and greenhouse gas reductions are minuscule. That's why the key will be changing to more environmentally friendly sources, such as agricultural waste, trees, or new crops. Pine groves in the South could supply 4 billion gal. of ethanol a year and revitalize declining rural communities, says Georgia Tech's Roger P. Webb. Stanford University biologist Chris Somerville calculates that, with the right plants,



Don't underestimate the ability of U.S. and global agriculture to respond to higher prices." -USDA ECONOMIST KEITH COLLINS

3.5% of the earth's surface could supply all of humanity's energy needs, compared with 13% now used for agriculture. One of the best candidates: perennial prairie grasses. Their deep roots store carbon captured from the air, improve soils, and require little water. Companies are now trying to breed the most productive varieties. Only 49 million acres could supply 139 billion gallons of ethanol a year by 2030, figures venture capitalist Vinod Khosla. "Farmers will be better off, the world will be less dangerously dependent on the Mideast, and we will take a giant step in greenhouse gas reductions," he argues. "There is little downside."

Of course, a lot could go wrong along the way. Methods to turn the cellulose from prairie grass into fuel may be hard to scale up. A host of unintended consequences could appear. And if the price of oil drops significantly, the whole biofuels bandwagon could come to a shuddering halt.

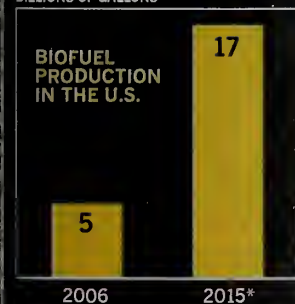
But a new world seems inevitable. "We have to be prepared for dramatic change in agriculture," says Nebraska pork farmer Joy Philippi. "There will be a tremendous shift." ■

-With Assif Shameen in Singapore

A NEW ERA FOR AGRICULTURE

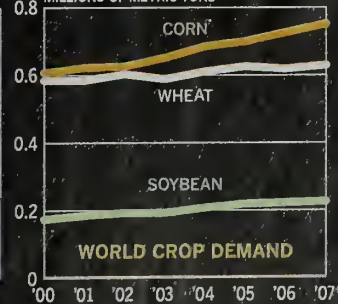
What happens when farmers plant crops for energy as well as food

BILLIONS OF GALLONS



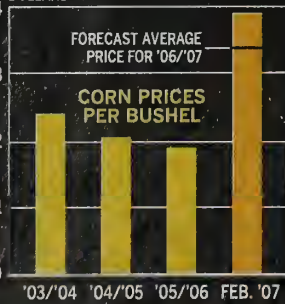
Data: Renewable Fuels Assn., National Biodiesel Board

MILLIONS OF METRIC TONS



Data: AgResources

DOLLARS



NOTE: CROP YEAR RUNS AUG. TO AUG.

Data: USDA, AgResources

PERCENT OF U.S. CORN USED FOR ETHANOL



*FORECAST

Data: USDA, AgResources

The Wild Ride to

Sandstorms, bandits, and brushes with death as a software executive savors the g

THEY HAD JUST CROSSED THE BORDER from Morocco to Mauritania when the dune buggy hit a ditch. Barreling over a dry lake bed at more than 100 miles an hour, loaded with 400 pounds of survival gear and spare parts, the custom-built buggy rolled six times. Software exec Ronn Bailey and his navigator, Kevin Heath, struggled against centrifugal forces to keep their arms in the cockpit. Amazingly, they emerged from their seat harnesses with just a few bruises. Bailey and Heath staggered around for an hour, gathering debris strewn the length of two football fields, as they waited for their support crew. "Our first idea was to strip the car of anything valuable and give it a Viking funeral," Bailey recalls. "But then I said: 'This isn't some race in the States. This is Dakar.'"

It has been called the world's most dangerous race—a 5,000-mile speeding caravan across six countries. It began this year on Jan. 8 in Lisbon and ended, as it always does, two weeks later in Dakar, Senegal. Over its 29-year history, the Dakar Rally has claimed some 50 lives, half of them competitors. This year was no exception. South African motorcyclist Elmer Symons, 29, was killed in a crash and France's Eric Aubijoux, 42, died of a heart attack.

Symons' Jan. 9 death prompted the Vatican newspaper *L'Osservatore Romano* to condemn the Dakar as "the bloody race of irresponsibility." French motorcycle racer Thierry Sabine, who founded the event, was more poetic years earlier when he called it "a challenge for those who go, a dream for those who stay behind." Sabine died in a helicopter crash while overseeing the race in 1986.

FIRESUIT BRIGADE

LIKE MOST AUTOMOTIVE events, the Dakar is a place for manufacturers to show off their hardware. Cars from Mitsubishi Motors and Volkswagen and motorcycles from Yamaha and Austrian manufacturer KTM Group have dominated the race. This year 515 vehicles entered and 300 finished, about the average. Drivers compete in one of three categories: cars, trucks, and motorcycles. NASCAR star Robby Gordon, who drove a Hummer H3, finished eighth in the car category.

For those of you still thinking of donning a helmet and firesuit, Bailey's experiences might discourage you. The 58-year-old founder and CEO of Vanguard Integrity Professionals, a Las Vegas software-security firm, learned about the Dakar from a German tourist he met motorcycling across South America 15 years ago. Bailey first entered in 2005 and was eliminated after he was caught for three days in a blinding sandstorm at the halfway mark.

Last year he was disqualified after missing a checkpoint at roughly the same spot.

Bailey says this year's race was toughest yet. Five weeks before leaving for Europe he trashed his buggy, careening down a 70-foot sand dune near his Nevada home. The car burst into flames, destroying almost half the vehicle. "It was just like the movies," Bailey recalls. "It was literally toast."

Bailey and his crew repaired the buggy, but trouble struck again when, in the second day of the race, he swerved to avoid a nonracing motorist who pulled out in front of him on a Portuguese highway. Bailey's vehicle hit the center divider, rolled five times, seriously damaging the exterior. With the buggy held together with duct tape, Bailey and Heath convinced local authorities to give them a police escort, and they caught the last ferry out of Morocco with five minutes to spare.

After his Jan. 11 wipeout in a Mauritanian lake bed, Bailey and his crew spent three hours checking or repairing equipment on the damaged part of the buggy. Then it was on to the next checkpoint, which they reached



Dakar

through the Sahara. **BY CHRISTOPHER PALMERI**

half-hour before the start of the next leg. us, the two serious spills were too much. iley failed to make a checkpoint on Jan. in Atar, during the eighth leg, after burn- through his second transmission. Navigating the Sahara presents more



challenges than the occasional sandstorm and 20-story dune. Participants can easily become dehydrated in temperatures that swing from 100 degrees during the day to freezing at night. Land mines are an issue, and bandits have been known to rob racers.

Heath, a 48-year-old South African businessman, was nearly held up during a race. Only the lucky appearance of race security forces saved him.

The Dakar Rally is broken down into 15 stages. Drivers must reach each endpoint by a certain hour or face disqualification. Participants are given a "road book" with directions, but those tend to be vague. "It could say turn left at a tire, see ruts in the road, and travel 183 degrees

SCENES FROM A RALLY (from left) Bailey on the sands of Morocco; after dropping out in Mauritania; a spectator with four-legged friends in Morocco; near the finish line in Senegal

for 22 kilometers," Bailey says.

Fielding a team is not cheap. Bailey spent \$1.4 million this year, half on his dune buggy, which has a 380-horsepower Chevy LS7 engine. He and his six-man, full-time team built it largely by hand. Bailey puts his expenses during the race at \$30,000 per man for a 12-person support crew, not including salaries.

He justifies the cost as good exposure for his business. Although not nearly as popular in the U.S., the Dakar is widely followed in the rest of the world. This year organizers estimate there were 580 hours of TV coverage in 178 countries. The race's Web site, dakar.com, gets 38 million page views in January.

Bailey says the Dakar experience has made him a better businessman. One lesson: the importance of testing. "Before we take a new part to a race, we run it for 20 miles to make sure it's race-ready," he says. "You don't assume the manufacturer sent you a good part."

The race also has made him tougher, Bailey believes. He has learned to take 15-minute catnaps to stay rested. For his first race, he hired a private security firm that trains Special Forces personnel to teach him off-road driving skills. He's already planning for next year. Bailey wants to return to Africa a few times this year to train on the dunes. "I'm just an adrenaline person," he says. "I love this stuff." ■

(MAP) STEVE STANKIEWICZ; (MAP) STEVE STANKIEWICZ; DAMIEN MEYER/AFP/GETTY IMAGES





BY JONATHAN SCHWARTZ

Lullabies in The Key of Carly

 “I WAS GOING TO DO a rock album with Booker T, without the MGs,” Carly Simon told me with a chuckle not long ago. “But we had a problem. Neither of us likes to fly, and he’s in California and I’m on Martha’s Vineyard. We thought about recording in Chicago. Then I got a call from a record producer who told me of a meeting at Columbia Records during which he had said: ‘Doesn’t the word lullaby sound synonymous with Carly Simon?’ As far as lullabies go, I knew the language.

Instead of a rock album with Booker T, we now have *Into White*, a gentle, generous CD, a beautiful contribution from a singer whose voice is as familiar to me as my own. My family and hers were friends, and I spent many summers at the Simons’ Connecticut home. Carly and I just about grew up together, sang everything together: “I’ll meet you in the barn after dinner.” “Do you think it’ll rain this afternoon?” Everyone sang. Carly’s two sisters, Lucy and Joanna; Uncle Peter; Carly’s mother; and the gypsies who wandered through.

Now Carly’s children, Sally, 33, and Ben, 29—their father is singer/songwriter James Taylor—

join her on many of the songs. The title cut, *Into White*, is a 1971 Cat Stevens’ song. The other tracks are for the most part songs we all know: *Oh! Susanna*, *Scarborough Fair*, *Blackbird*, *You Are My Sunshine*, *Jamaica Farewell*, and *Somewhere Over the Rainbow*. You may not know the name of the theme from the 1959 film *Black Orpheus*—it’s *Manha de Carnaval*—but you’ll recognize the melancholy melody. Carly’s lyric is simply la-la-la-la-la-la-la.

Let’s consider this re-

markable artist. Carly is 61, and has been recording since 1971. Her first hit single, *That’s the Way I Always Heard It Should Be*, was an entirely original and somewhat spooky glimpse of her family’s dark corners. Jacob Brackman, a close friend and superb essayist for *The New Yorker* at the time, captured the corridors of her parents’ marriage, and set his lyric to Carly’s remarkable melody.

Could it be that it’s 36 years later?

Think of the albums, the film scores, the videos, the hit singles—*Anticipation*, *You’re So Vain*, and *Let The River Run*—a bundle of them. An outpouring from creative spirit over so many years.

Carly came from a background of classical music and American standards. In the late 1960s she embraced rock, music of different shapes and often with sharper inflection, making recordings that might have unnerved Richard Rodgers or Jerome Kern (but not necessarily George Gershwin, who had turned all sorts of corners in *American in Paris*, *Rhapsody in Blue*, and *Concerto in F*).

“Your voice won’t ever let you down,” told her last summer. “Happily you have no vibrato. You could go on forever.”

On *Into White* she is soothing and assuring. The minimalist arrangements are utterly beautiful. They are delicate, sweet things, those arrangements, collaborating with Carly through a peaceful, knowing glance. Come to think of it, that is what *Into White* is all about: a peaceful, knowing glance to its self and to us, who have lived through the music from our childhoods to now, all of us, a nice crowd of intimates, gathered around the stereo for music that will never end. ■

Jonathan Schwartz hosts *High Standards*, a channel on XM Satellite Radio, as well as weekend shows on WNYC-FM, a New York public radio station.

CARLY SIMON On *Into White*, her voice is soothing alongside simple arrangements



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BY ROBERT PARKER

Great Deals From Provence

Many wine lovers feared that *A Good Year*, the recent film starring Russel Crowe and based on Peter Mayle's book about living at a vineyard in Provence, would cause a surge in demand for wines from that region. They can relax: The movie bombed, so there still are plenty of great deals on wines known as Côtes du Rhône or Côtes du Rhône-Villages. These are usually blends of grenache, syrah, and mourvèdre grapes. ¶ Here are some domaines that make fine red Côtes du Rhône's selling for less than \$25 a bottle. The vintage of choice is 2005, followed by 2004. All should be enjoyed in their first three to six years of release.

Les Aphilanthès

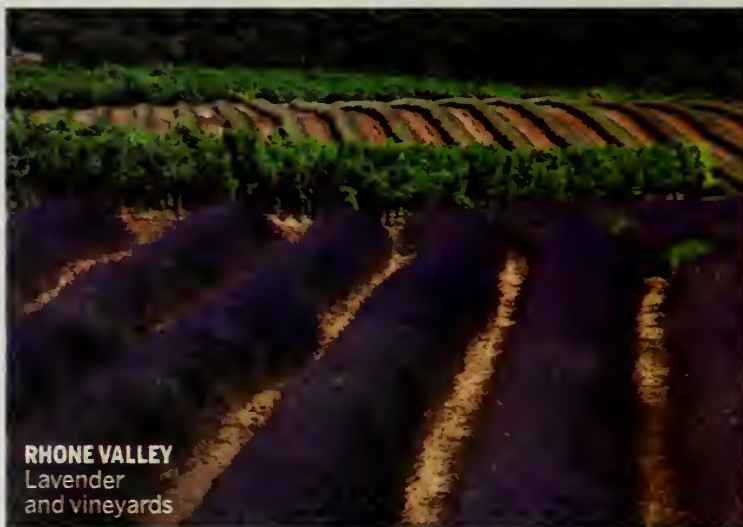
This superstar estate run by the highly talented Daniel Boule produces a number of Côtes du Rhône cuvées that are serious, filled with character, and sell for a song. Imported by Weygandt-Metzler (610 486-0800).

Domaine du Caillou

Known for its exquisite Châteauneuf-du-Pape, which sells for \$75 to \$100 a bottle, Domaine du Caillou also produces bargain-priced Côtes du Rhône, Reserve Côtes du Rhône-Villages, and Côtes du Rhône-Villages Très Vieilles Vignes that taste like most others' Châteauneuf-du-Pape. The 2005s are beauties. Caillou's wines are available through various American importers, including Michael Skurnik (516 677-9300) and Diamond Wine Merchants (510 567-9887).

Domaine Fondrèche

Adjacent to the Côtes du Rhône is the sun-swept Côtes du Ventoux appellation, and Fondrèche is its top property. There, Sebastien Vincenti, one of France's finest



RHONE VALLEY
Lavender
and vineyards

young winemakers, produces a bevy of grenache and syrah-based gems. Fondrèche is also a good source for terrific whites. Imported by Robert Kacher Selections (202 832-9083).

GAEC Charvin

This tiny artisanal producer is well-known among insiders for its old-style yet glorious Châteauneuf-du-Pape. Its seductive Côtes du Rhône Le Poutet is a food-friendly effort that pleases the senses, the intellect, and the

pocketbook. Imported by Weygandt-Metzler (610 486-0800).

Guigal

This superb domaine is renowned the world over for single-vineyard Côte Rôties, Hermitages, and Condrieus. By volume produced, Guigal's biggest wine is the Côtes du Rhône. It's usually a blend of equal parts syrah and grenache, with a touch of mourvèdre. This offering is always delicious and a great bargain. Imported by Ex Cellars Wine Agencies (805 686-9153).

Patrick Leseec Selections

Leseec, a négociant working in southern France, selects top wines from some of the region's better cooperatives and bottles them under such names as Marquis, Pétrillière, and Peradon. Imported by Chemin des Vins (508 545-1532).

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see ter of thousands of tasting notes, buy his books, subscribe to his newsletter, The Wine Advocal

For more on the domaines producing great Côtes du Rhône wines, go to businessweek.com/extras.

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asset allocation



adding to savings

Running the Number

New services take a detailed look at what you've socked away. **BY ANNE TERGESI**

LAST FALL, WITH HIS 60TH BIRTHDAY coming up, Roy Campfield consulted the financial-services industry's equivalent of a crystal ball. The Missoula (Mont.) dentist's goal: to find out whether his finances are in good enough shape for him to retire in five years. Naturally, no one can predict the future. But Campfield, an avid hiker, fisherman, and marathoner, put a range of data, including his portfolio holdings and how much he'd like to spend in retirement, into sophisticated software offered by T. Rowe Price. The Baltimore company also paired Campfield with one of its advisers. The result, a solid thumbs-up, "gives me enormous peace of mind," says Campfield. Such analytical tools are proliferating as financial-services firms vie to serve baby boomers as they near retirement.

In the past year, T. Rowe Price, Vanguard, and Merrill Lynch, among others, have announced new or revamped advisory services that issue detailed forecasts of how much you're likely to earn and spend in retirement, using increasingly sophisticated technologies to keep on

RETIREMENT
DO YOU HAVE
ENOUGH?

top of it all. Charles Schwab plans to launch a free service this year.

Mainly for those in or near retirement, these services are not soup-to-nuts financial-planning programs. If you need tax- or estate-planning help, you may have to seek it elsewhere.

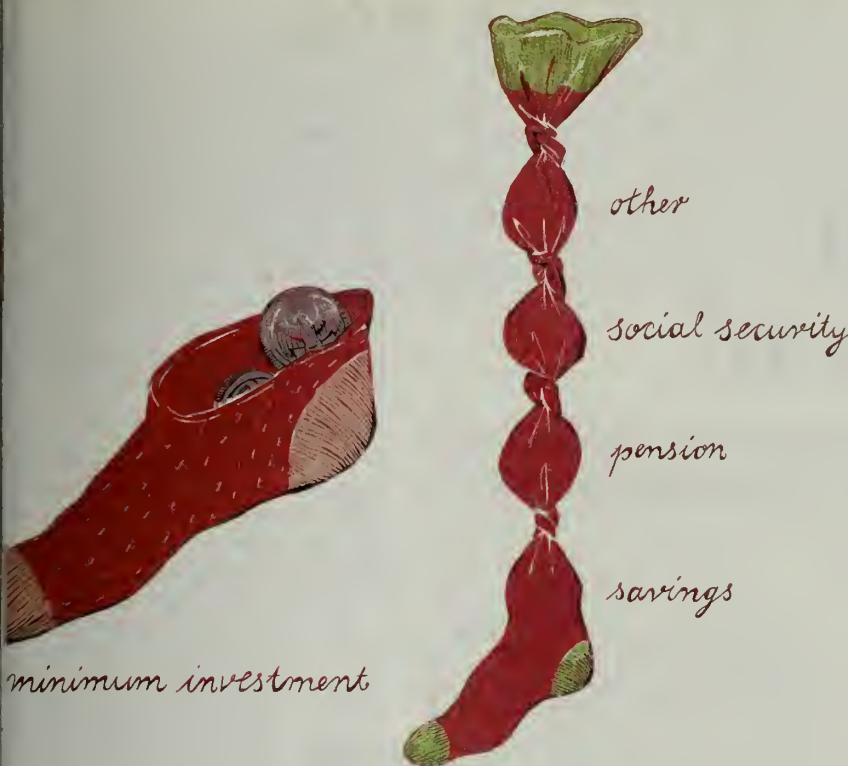
Which firm's offering is best for you depends in part on how much time you want to spend, how much handholding you need, and how much you want to pay. To help you choose, *BusinessWeek*

looked at five programs and identified key factors to consider (table).

THOROUGHNESS

MOST OF THESE SERVICES start with an online questionnaire. Gather statements from your bank, brokerage, and retirement accounts. Be prepared to spend minutes to two hours. All automatically retrieve data on accounts you hold there. Some can do the same for investments held elsewhere, provided you furnish account numbers and passwords.

If you're detail-oriented, go for Fidelity Retirement Income Planner. Its budget worksheet alone asks more than 40 questions, covering everything from groceries to gasoline. You can vary estimates of future expenses, such as mortgage payments, from year to year. For faster answers, give an estimate of your total spending. T. Rowe Price Vanguard simply asks you for a total net worth. If you haven't a clue what that may be, they generally suggest you use 70% to 80% of your pre-retirement income



services don't always use the same assumptions about key inputs, such as how long you're likely to live. But they'll justify these on request.)

NO-HOLDING

ALREADY ALL REQUIRE YOU to work with an adviser. What that means varies. Clients using Fidelity's Retirement Income Planner can sit down with an expert at one of 114 investor centers or communicate with call-center representatives via phone or e-mail any number of times. Do-it-yourselfers can log on to a password-protected site and work alone. (Schwab is also offering a similar range of options.) If you have accounts at Merrill and use Retirement Income Service, you'll work one-to-one or on the phone with the same adviser who handles your other business. Typically, clients with advisers have at least \$250,000 in investable assets. Vanguard, T. Rowe Price, and Schwab all pair you with an adviser, but contact is more limited. Vanguard's reps spend about 45 minutes on the phone with new clients, though they'll give more time to those who need it. T. Rowe Price schedules at least two phone conversations with an adviser. Both T. Rowe Price and Vanguard offer unscheduled follow-ups, but you may always speak to the same adviser.

INVESTMENT ADVICE

FROM MERRILL, the firms fit clients into one of a preset menu of portfolios, stocked mainly with mutual funds.

T. Rowe Price has 10. Vanguard will soon offer nine, up from seven. The one you get usually depends on your age and responses to questions about risk.

All allow you to retain any current holdings. When recommending new investments, Vanguard and T. Rowe Price generally favor their own funds, while Fidelity, Schwab, and Merrill build portfolios with funds managed by hundreds of firms. Merrill also goes beyond mutual funds, using investments such as annuities and hedge funds.

Asset-allocation advice varies, too.

Michael Cotter, a semi-retired developer from Vero Beach, Fla., sampled Vanguard's and T. Rowe Price's services. He chose Price because it had a 70% allocation to equities, vs. Vanguard's 50%, which he thought was too conservative.

ONGOING SERVICES

ALREADY RETIRED? Fidelity and Merrill can track your income and spending if you route all deposits and withdrawals through them. They'll compare your spending with what your plan says it ought to be and notify you if your net worth lags expectations. Vanguard and T. Rowe Price offer free annual checkups, with advice for those having trouble. For help deciding which investments to tap for cash, just ask. T. Rowe Price will even take the amount it figures you can afford to spend each year from your investment accounts and send it to your bank account.

COST

TABS GO FROM free at Fidelity and Merrill to \$1,100 at Schwab. Vanguard waives its \$1,000 fee for those with \$250,000 or more at the firm or who transfer at least \$100,000. At T. Rowe Price, the \$250 fee goes away if you bring \$100,000 or have \$500,000 at the firm. ■

BusinessWeek .com

For more on planning and monitoring your retirement portfolio, visit us:

ONLINE at businessweek.com/extras

ON TELEVISION at our weekly show, *BusinessWeek Weekend*. Go to businessweekweekend.com to see video clips, or type in your Zip Code to find out when and where it airs in your area.

The Right Plan for You

Advisory services can help you figure out how to shift your portfolio and how much you can safely spend. They'll also help monitor your net worth, spending, and income after you retire.

FIDELITY INVESTMENTS RETIREMENT INCOME PLANNER

Good for those who are detail-oriented. A cash-management tool provides real-time updates on whether you're meeting your financial goals.

MERRILL LYNCH RETIREMENT INCOME SERVICES

For those who want to work with a dedicated adviser. A cash-management tool

monitors whether you're spending too much or earning too little to keep pace with your financial plan.

CHARLES SCHWAB CHARLES SCHWAB RETIREMENT

CONSULTATION Pairs you with an adviser to create a plan, but provides no ongoing help. A new free service will roll out later this year for clients.

T. ROWE PRICE ADVISORY PLANNING SERVICES

For younger clients as well as retirees and the almost-retired. Generally provides two phone conversations, plus free annual checkups.

VANGUARD GROUP VANGUARD FINANCIAL

PLAN Clients get at least one phone conversation, plus free annual checkups.

The 401(k) Smorgasbord

More companies are offering self-directed accounts with a wide range of choices. **BY LAUREN YOUNG**

IF YOU THOUGHT HAVING 10 investment options in your 401(k) plan was overwhelming, imagine having thousands. By adding brokerage windows, also known as Self-Directed Brokerage Accounts (SDAs), to their retirement plans, more companies are offering a vast array of choices to their employees.

Cisco Systems, ITT, and Eastman Kodak are among the corporations that have added windows to their retirement plans in the past year. Plenty of state and city programs also feature them. These windows open to a brokerage account that gives you access to many or all of the nearly 7,000 mutual funds and exchange-traded funds in existence. Stocks and options also may be available, and you can usually trade as much as you like. SDAs can help you replace the core investments in your retirement account, but they are especially useful if you want to move to the more far-flung corners of the financial universe, such as emerging markets, international bonds, real estate, and commodities. Most plans don't offer such exotic choices. "The opportunity for diversification is a beautiful thing," says Rick Miller, an adviser at Sensible Financial Planning in Boston.

If your 401(k) plan offers an SDA, don't feel compelled to use it. Since Cisco added a window to its retirement plan in 2006, less than 3% of its U.S.-based workforce of 30,000 has signed up, Cisco spokeswoman Abby

Smith says. Studies show participation rates at big companies run from 2% to 8%. "While we are pleased to offer our employees increased flexibility in investment choices, we realize this is a program that is best suited for astute investors," Smith says.

Do not even consider opening up an SDA unless you can commit at least \$50,000 of your 401(k), says Kay Conheady, a fee-only financial adviser at Apropos Financial Planning in Rush, N.Y. "It's not easy to mim-

imize the costs if you're investing in securities accounts."

Although taxes aren't a concern with a tax-deferred SDA, you do need to watch the costs. Commissions vary from provider to provider, but it typically costs \$10 to \$15 per trade. If you are a frequent trader, that can add up. Administrative fees to cover record keeping and other expenses can be as high as \$100 per year, but some employers absorb those costs.

ASSEMBLY REQUIRED

IF YOU ARE BUYING mutual funds, you also need to pay attention to the underlying costs and whether you'll pay a sales charge. To get the best deal, see if your plan offers funds without transaction fees. If not, you may have to pay \$75 for each purchase.

When you are ready to climb through that window, start off slowly. Vincent Joseph, 34, a controller at oil giant Schlumberger in Houston, spent two years selecting the 12 funds he needed for his asset allocation portfolio. Although employers don't offer help in choosing investments, SDA providers such as Fidelity Investments and Charles Schwab can help you with an adviser.

Make sure you also consider the time it will take to monitor your investments. Charlene Williamson, 56, of Dallas, goes far beyond what most people do with a retirement account. Following a sophisticated strategy that uses calls, puts, and stocks, she spends about six hours a month trading in her husband's retirement SDA. (She oversees the family finances.) But it has been worth it: At the Williamsons made the switch, her portfolio rose 8% in four months, she says. Some people like the flexibility of an SDA, but they don't have the time or savvy to run it right. So they hand over control to an investment manager. In the first quarter of 2006, SDA assets at Schwab were managed by the financial adviser plan participants.

Just because the window is open doesn't mean the sky is the limit. "Most plans restrict the funky stuff," says Robert Jesch, a director in Schwab's corporate and retirement services division. That includes futures, currencies, private placements, and derivatives. Your employer may also set a cap on how much of your retirement account you can invest through a brokerage window. If stocks are offered, plans usually restrict purchases to companies listed on major exchanges. In other words, you won't find any "pink sheets" (over-the-counter stocks) hanging in these windows. ■

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FINANCIAL SERVICES

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BREATHING ROOM Jean Ingram's reverse mortgage allowed her to hold on to her home in California

Pumping Up Your Reverse Mortgage

New 'jumbos' are giving retirees the cash they need to stay in their houses. **BY ELLEN HOFFMAN**

FROM THE LIVING ROOM of her Huntington Beach home, Jean Ingram enjoys sweeping views of pristine California wetlands and, off in the distance, Catalina Island. She and her late husband paid \$135,000 for the 2,200-square-foot Tudor-style home in 1978, and it's now valued at about \$1.2 million. Yet until late last year, the 69-year-old widow, awash in home equity but light on monthly income, feared she would have to sell.

Ingram was able to hold on to the house by taking out a jumbo reverse mortgage on the property—"jumbo" because the amount was \$388,000, and conventional reverse mortgages would not offer as much on a \$1.2 million home. Either way, these financial deals allow homeowners 62 and older to take

the equity out of their houses without having to make monthly payments to the bank. The balance comes due when the homeowner moves out or dies. Then, the mortgage holder or the heirs have to sell the property or use other funds to pay off the loan if they want to keep it.

Financial Freedom Senior Funding, based in Irvine, Calif., has been the main source of the supersize loans since 2000 (financialfreedom.com/reversemortgagecalculator). But more providers are entering the field, offering variations on the loans and increasing competition, says Peter Bell, president of the National Reverse Mortgage Lenders Assn., a trade group (reversemortgage.org). BNY Mortgage, based in Newburgh, N.Y., plans to offer the first fixed-rate jumbo reverse mortgage in Feb-

ruary. It will be available initially in 10 Eastern states and later in other states through collaborating lenders.

Ingram's mortgage, most of its ilk, is variable, with the interest tied to the widely quoted London Interbank Offered Rate. Her rate is currently 8.42% and can reach every six months, up to a maximum of 14.92%. The 8.42% rate is about 2 points higher than the interest on a regular adjustable-rate mortgage. What's the significance is the interest rate if you're not making monthly payments?

the basis for calculating how much Ingram or her heirs will eventually have to repay the lender.

Because she chose to take all the money up front, rather than in a line of credit, the mortgage company waived its registration fees and closing costs. With cash from the reverse mortgage, Ingram paid off her original loan, upgraded her roof and patio, and stashed \$150,000 in certificate of deposit. She hopes to buy a condominium that will throw off rental income.

How much do the jumbos really cost? Suppose you took a \$700,000 reverse mortgage on a home valued at \$2 million, with a fixed interest rate of 8.8%. Depending on how fast you took money out, the debt could balloon to between \$915,000 and \$1.7 million in 10 years, says Jim Mitchell, a reverse mortgage specialist at Financial Freedom.

The final bill would include accrued interest, service charges of \$20 a month, and original closing fees. If the home appreciated 4%

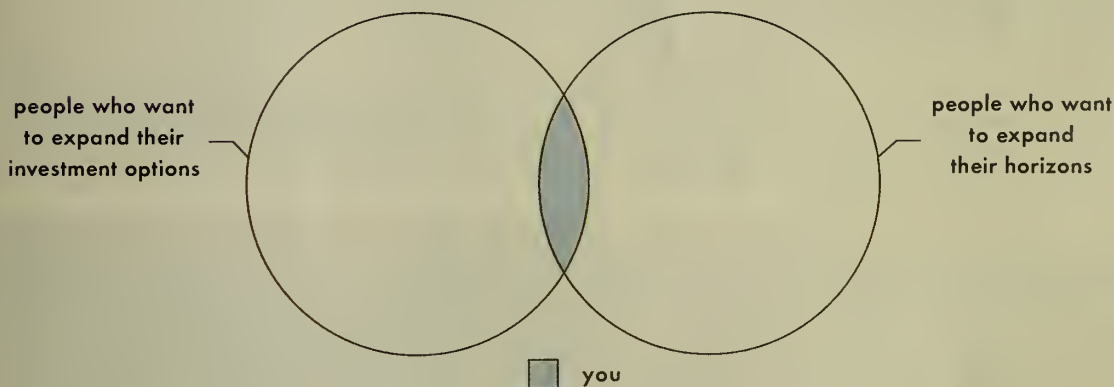
year during the 10 years, it would be worth nearly \$2.7 million. You or your heirs could sell it, pay off the loan, and have a tidy profit.

Plans can go awry, however. Say you become ill and need to move out and sell the home immediately. If interest rates have skyrocketed and the property value has remained flat, your equity could be wiped out. But at least the amount you owe would never exceed the market value of the home. ■

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ENOUGH?



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Northern Trust

Pay Off the House? Not So Fast

It may be smarter to invest the extra money instead of eliminating your mortgage. **BY ELLEN HOFFMAN**

IF YOU ASK YOURSELF WHETHER you should pay off the mortgage before you retire, your first impulse may be to say: "Why not?" Many people have an instinctive desire to own the house free and clear before they stop working, figuring the absence of a monthly mortgage payment will help relieve the pressure of living on a reduced income.

But prepaying your mortgage may not be the savviest move, particularly from a tax standpoint. This is especially true when faced with the choice between fully funding a tax-deferred 401(k) or adding to your mortgage payment each month. It even applies when the alternative is to invest more in a taxable account.

The reasons to channel the money into retirement savings are clear. Every dollar you sock away in a 401(k), individual retirement account, or other tax-deferred plan saves taxes now and lets your money grow tax-free over the long term. Taxes come due only when you withdraw, usually when your income and tax rate are lower.

TAX SAVINGS

TAKE THE CASE of a 50-year-old couple in the 33% marginal tax bracket who want to retire in 10 years. They have \$400,000 left on their 30-year, 6% mortgage, and each is eligible to contribute \$20,500 a year to their 401(k)s. Karen Folk, a financial planner in Urbana, Ill., calculated the impact of putting \$41,000 a year into their 401(k)s vs. diverting it to pay the mortgage.

In the first scenario, the couple maxes out the 401(k)s. After 10 years, even earning a modest 6% return, the two accounts

would accumulate \$559,922. With an 8% return, the accounts would gain about \$625,066. That's more than enough, even after taxes, to pay off the remaining mortgage debt of about \$175,000. In addition, the couple would have saved nearly \$200,000 in taxes—\$59,000 from the mortgage interest deduction and a deferred amount of more than \$135,000 because of the 401(k) contributions.

Alternatively, if they put the entire \$20,500 each into prepayments, the mortgage would be paid off in less than six years, leaving them just four years to pay the full \$41,000 into their 401(k). Under this scenario, they end up with a paid-off mortgage and \$385,000, if the 401(k) return is 6%; \$402,000, if the return is 8%. Tax savings from the mortgage interest deduction and the deferred 401(k) contributions come to

about \$81,000, less than half that saved by putting all the money into 401(k)s.

Even if you're already maxing out retirement account contributions, investing extra money in a taxable account may be smarter. After JPaul Dixon, 38, a vice-president at insurance broker Hylant Group in Ann Arbor, Mich., made a \$110,000 profit on the sale of his home, he thought he could put more money into a new \$435,000 house and therefore pay it off sooner. But his adviser showed Dixon that he'd benefit more by putting 20% down and investing the \$110,000. At an annual return of 8% over 20 years, Dixon would end up with \$512,705, more than enough to pay off the balance on the \$348,000 mortgage he just took on.

You should also keep the mortgage if a big chunk of your payment is tax-deductible interest. Frank Moore, Dixon's financial planner, says the aftertax cost of a 6% mortgage is about 4% for taxpayers in the 33% bracket. If you can earn more than 4% after taxes, you're better off not prepaying the mortgage.

Of course, if you don't think you'll have the discipline to invest the money, or if you're close to the end of the mortgage anyway and the tax benefits have dwindled, you just might pay it off. And don't discount the emotional aspect of your decision, says J. Steven Cowen, a financial planner in La Jolla, Calif. Knowing that his own business could face a downturn at any time, Cowen and his wife decided to kick in an additional \$1,000 a month to mortgage payments. Their desire to stay in their house for the rest of their lives was reason enough.

**RETIREMENT
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ENOUGH?**



DIXON He opted to put \$110,000 into investments rather than make a bigger downpayment

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BY GENE G. MARCIAL

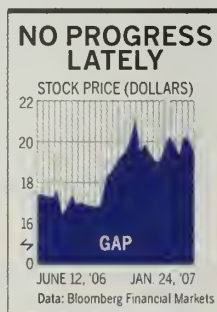
BELEAGUERED **GAP** IS EXPLORING ITS OPTIONS.

WHY **LOUISIANA-PACIFIC** STOCK CAME OUT OF THE WOODS.

MORE GOVERNMENT AND RETAIL USERS TURN TO **INTELLI-CHECK**.

Seismic Change at Gap?

IT'S A TOUGH CALL for an analyst in an awkward spot. Margaret Mager of Goldman Sachs is probably not too comfortable with her "sell" recommendation on Gap (GPS). The specialty apparel retailer recently hired Goldman to explore strategic alternatives, since sales continue to deteriorate. The stock is down from 21 on Oct. 22 to 19.38 on Jan. 24. Mager stands firm on her sell. In a report, Mager says Gap "can't realistically explore strategic options until its business is performing better." Paul Pressler's resignation as CEO on Jan. 22, she says, was no surprise, but "it is a necessary change." Mager adds that her reservations "remain numerous" and "will challenge any CEO or new management team." But Michelle Clark of Morgan Stanley, which owns shares and has done banking for Gap, rates it "overweight" in anticipation that some "value-creating change initiative is near." One possibility: a leveraged buyout, or a spin-off of one of its units—probably Banana Republic. She values Gap at 23-25 in an LBO. She says Chairman Robert Fisher's family, which owns 37%, could lead an LBO with private equity groups. Dana Cohen of Bank of America, who also rates Gap a buy, values the stock at 25, assuming an 80% probability of a turnaround.

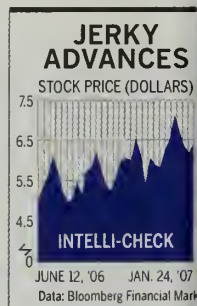


makes siding. BofA's George Staphos says the upgrade is based on several factors, including a sum-of-the-parts/replacement value, and a buyout model. Staphos says new capacity could add pressure on the industry, but any drop in the stock price should be a chance to buy. Improving industry conditions, plus LPX's cash of \$1.2 billion "provide downside protection," says Staphos.



Those Fake IDs Won't Fool Intelli-Check

ONE OF THESE DAYS, CEO Frank Mandelbaum hopes Intelli-Check (IDN), the company he founded, will become a generic term for systems to detect falsified IDs. The company makes ID readers to authenticate the validity of a driver's license or other ID. Intelli-Check also licenses its software to retailers seeking to cut losses from fake IDs. Mandelbaum says the government is Intelli-Check's biggest customer because of security concerns. The Defense Dept. has ordered Intelli-Check's ID-Check technology so it can be embedded in handheld computers used by the Pentagon Force Protection Agency. "The order validates the technology for document verification as spelled out by Homeland Security," says John Bendall, president of Hermitage Capital, which owns shares. He puts the market for the handhelds for first-responders—such as police and security guards—at \$300 million. With giant retailers Target and Toys 'R' Us and car-rental outfits using ID-Check, "it's likely Wal-Mart and FedEx will start, too," says Bendall, who sees the stock, now at 6.26, at 12 in a year. David Sterman of Jesup & Lamont rates Intelli-Check neutral but says it's on track to generate strong sales growth and impressive gross margins in the next four to six quarters. ■



Buyers Are Eyeing Louisiana-Pacific

PAPER AND FOREST PRODUCTS have yet to join the bull run because the housing slump is hampering sales. But one, Louisiana-Pacific (LPX), has jumped ahead. It's up from 18 in September to 23.33 now, buoyed by rumors that it's a buyout target and by "signs of a bottoming" in homebuilding. Michael Metz of Oppenheimer says this is the time to buy, adding: "LPX is very attractive to private equity groups who are eyeing it as a leveraged buyout because of its assets and cash." Metz figures LPX is worth more than 27 in a deal. Bank of America, which owns LPX shares and recently upgraded the homebuilding group, increased its rating on LPX from neutral to buy and raised its 12-month target from 24 to 25. LPX is the world's top producer of oriented strand board (OSB), a cheaper alternative to plywood. It also

BusinessWeek .com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

A large semi-truck with a damaged roof is stopped on a highway at night. Three people, including two police officers in blue uniforms and hats, are standing near the truck. A white police car with "TROOP" on the side is visible. A red triangular warning sign is on the ground in the foreground.

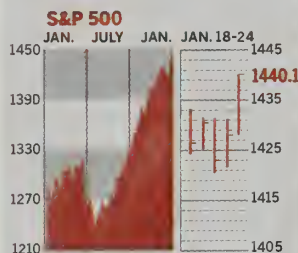


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STOCKS



COMMENTARY

Earnings results were good enough to send the indexes higher this week. JPMorgan Chase gained after its profits beat analysts' expectations. AT&T was up nearly 7% after its Cingular Wireless unit reported a jump in subscribers. As oil prices edged up, so did shares of Exxon Mobil. IBM shares fell; profits were up, but investors expected more.

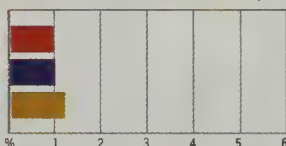
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED JAN. 23

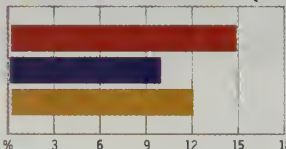
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED JAN. 23

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	JAN. 24	WEEK	YEAR TO DATE	LAST 12 MONTHS
S&P 500	1440.1	0.7	1.5	13.7
Dow Jones Industrials	12,621.8	0.4	1.3	17.8
NASDAQ Composite	2466.3	-0.5	2.1	8.9
S&P MidCap 400	827.0	1.0	2.8	7.7
S&P SmallCap 600	404.0	0.7	1.0	9.0
DJ Wilshire 5000	14,458.1	0.7	1.7	13.1

SECTORS

	JAN. 24	WEEK	YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	813.1	0.6	1.8	6.6
BW Info Tech 100**	456.5	0.8	2.0	18.6
S&P/Citigroup Growth	662.7	0.3	1.6	9.5
S&P/Citigroup Value	775.9	1.0	1.5	18.0
S&P Energy	447.5	4.1	-1.8	7.2
S&P Financials	501.6	0.8	1.3	18.3
S&P REIT	210.9	1.9	6.1	30.3
S&P Transportation	269.3	0.4	2.1	5.7
S&P Utilities	185.2	1.3	-0.7	10.8
GSTI Internet	201.1	0.6	0.7	-2.1
PSE Technology	890.4	-1.2	1.7	3.3

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	JAN. 24	WEEK	YEAR TO DATE	% CHAN L M
S&P Euro Plus (U.S. Dollar)	1995.3	0.7	0.3	2.4
London (FT-SE 100)	6314.8	1.8	1.5	1.1
Paris (CAC 40)	5638.1	1.4	1.7	1.1
Frankfurt (DAX)	6748.4	0.7	2.3	2.2
Tokyo (NIKKEI 225)	17,507.4	1.4	1.6	1.1
Hong Kong (Hang Seng)	20,821.1	3.8	4.3	3.3
Toronto (S&P/TSX Composite)	13,010.7	2.2	0.8	1.1
Mexico City (IPC)	27,338.3	2.9	3.4	4.4

FUNDAMENTALS

	JAN. 23	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.78%	1.77%	1.79%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.6	17.9	17.1
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.0	14.7
First Call Earnings Surprise*	5.06%	5.93%	3.81%

*First Call

TECHNICAL INDICATORS

	JAN. 23	WEEK AGO	YEAR AGO
S&P 500 200-day average	1326.7	1326.7	Positi
Stocks above 200-day average	75.0%	73.0%	Negati
Options: Put/call ratio	0.88	0.71	Positi
Insiders: Vickers NYSE Sell/buy ratio	6.26	6.10	Negati

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	27.2	Steel	63.9
Constr. Materials	15.0	Constr. Materials	46.7
Retail REIT's	12.2	Intgrd. Telecomms. Svcs.	46.5
Residential REIT's	11.9	Broadcasting	42.9
Office REIT's	11.8	Tires & Rubber	41.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Distillers & Vintners	-5.6	Education Services	-
Oil & Gas Drilling	-3.7	Gold Mining	-
Photographic Products	-3.4	Homebuilding	-
Semiconductor Equip.	-3.3	Electric Mfg. Svcs.	-
Instrumentation	-3.2	Oil & Gas Refining	-

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	5.6	Pacific/Asia ex-Japan	35.9
Pacific/Asia ex-Japan	4.1	Real Estate	31.8
Latin America	4.0	Latin America	28.9
Health	2.7	Europe	27.7
LAGGARDS		LAGGARDS	
Natural Resources	-0.7	Japan	-0.5
Utilities	-0.4	Natural Resources	1.6
Technology	-0.1	Technology	2.7
Small-cap Blend	0.1	Small-cap Growth	4.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
iShares MSCI Malaysia Idx.	11.3	Dreyfus Prem. Grtr. China A	76.6
Dreyfus Prem. Grtr. China A	11.2	Old Mut. Clay Finlay Ch. A	66.9
Volumetric	10.0	Oberweis China Opport.	63.4
ProFunds. Real Est. Inv.	9.0	Gartmore China Opps. A	60.2
LAGGARDS		LAGGARDS	
MH Elite Small Cap	-11.1	DireXn. Emrg. Mkts. Short	-40.2
Advance Capital I Eqty Gr.	-8.6	DireXn. Dev. Mkts. Bear 2X	-33.2
Marco Targeted Return	-8.1	American Heritage Grth.	-25.0
Matthews Korea	-6.9	BlackRock Real Invest. C	-24.5

INTEREST RATES

KEY RATES

	JAN. 24	WEEK AGO	YEAR AGO
Money Market Funds	4.90%	4.86%	3.3
90-Day Treasury Bills	5.13	5.11	4.1
2-Year Treasury Notes	4.93	4.91	4.1
10-Year Treasury Notes	4.81	4.78	4.1
30-Year Treasury Bonds	4.91	4.87	4.1
30-Year Fixed Mortgage†	6.12	6.11	5.1

† BankQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BDND	30-YR. BC
General Obligations	3.88%	4.24
Taxable Equivalent	5.54	6.06
Insured Revenue Bonds	4.00	4.50
Taxable Equivalent	5.71	6.43

THE WEEK AHEAD

FOMC MEETING Tuesday, Jan. 30, 9 a.m. EST » The Federal Open Market Committee meets for a two-day monetary policy meeting. Every economist queried by Action Economics expects interest rates to remain at 5.25%.

GROSS DOMESTIC PRODUCT Wednesday, Jan. 31, 8:30 a.m. EST » Fourth-quarter real gross domestic product probably grew at an annualized rate of 3%, after a 2% increase in the third quarter.

EMPLOYMENT COST INDEX Wednesday, Jan. 31, 8:30 a.m. EST » Compensation most likely grew 0.9% in the fourth quarter, after a 1% rise in the prior period.

PERSONAL INCOME Thursday, Feb. 1, 8:30 a.m. EST » Personal income probably increased by 0.6% in December, following a 0.3% gain in November. Consumer spending most likely climbed 0.6% in the month, following November's 0.5% rise.

PURCHASING MANAGERS' INDEX Thursday, Feb. 1, 10 a.m. EST » The Institute for Supply Management's January factory activity index likely reached 52%, from 51.4% in December.

EMPLOYMENT Friday, Feb. 2, 8:30 a.m. EST » Nonfarm payrolls in January are forecast to have risen by 145,000 workers, after a gain of 167,000 the month before. The jobs rate very likely held at 4.5% for a third straight month.

The BusinessWeek production index rose to 291.7 for the week ended Jan. 13, a 7.4% gain from the previous year. Before calculation of the four-week moving average, the index climbed to 294.3.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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BY DAY, I'M A
HIGH-POWERED
EXECUTIVE.
AT NIGHT,
I ZAPPOS LIKE
EVERYONE ELSE.



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The Battle for Air Supremacy

BOEING VERSUS AIRBUS The Inside Story of the Greatest International Competition in Business

By John Newhouse; Knopf; 254pp; \$26.95

It looked bleak for Boeing at the end of 2004. In a stunning reversal, Air Berlin, a longtime Boeing customer, announced a deal to buy more than 100 jets from chief rival Airbus. The German order was one of many that favored Airbus that year. Worse, sales of Boeing's new fuel-sipping jet, the 787 Dreamliner,

were tepid. Boeing CEO Harry Stonecipher was furious. He ordered the top sales chief fired and even threatened to oust Alan Mulally, then head of Boeing's commercial airplane division. Airline execs complained that Boeing was taking them for granted.

In mid-January of 2005, Airbus turned up the pressure, rolling out its gleaming new A380 superjumbo jet and securing its first order for the plane from an airline in China, the world's most important commercial aircraft market. But just as it seemed the handwriting was on the wall for the U.S. company, "fortune pivoted abruptly in Boeing's direction," writes John Newhouse. Boeing started winning some "bitterly hard-fought campaigns" pitting the 787 against the new Airbus A350. Thus began a Boeing revival that continues to this day.

In *Boeing Versus Airbus: The Inside Story of the Greatest International Competition in Business*, Newhouse offers an instructive look at the two airplane companies during the latter half of the 1990s and into the new century—a period when the momentum in their rivalry was swinging to Airbus and then swiftly turned back to Boeing. The author, a former writer at *The New Yorker* and author of an influential 1982 volume on the commercial airplane industry, *The Sporty Game*, depicts the U.S. company as struggling with a variety of issues in the late 1990s, particularly that of absorbing new acquisitions and managing a much enlarged company. But he also captures the more recent decline of Airbus and the story behind the troubles plaguing its A380. Although the book suffers somewhat from thin reporting and occasional generalizations, it represents a valuable overview of one of the most fascinating and complex stories in business.

The rivalry intensified in 1999, when Airbus passed Boeing in total sales and, with much fanfare, announced the launch of the A380. Boeing, meanwhile, was making a rather tepid effort to protect its eroding market share. It was struggling with self-inflicted production meltdowns and had become conservative and unwilling to launch new models. Boeing's 220-passenger

787 Dreamliner, the first large carbon-fiber-based commercial jet, was no more than a glint in an engineer's eye. Meanwhile, Boeing's senior execs were preoccupied with absorbing the defense and space acquisitions of Rockwell Aerospace, McDonnell Douglas, and Hughes Space & Communications. The ensuing culture clash was bitterly dividing the company.

Newhouse offers an engrossing behind-the-scenes look at the 1997 merger talks between Boeing and McDonnell Douglas. He provides considerable detail on how McDonnell outfoxed Boeing. For example, both boards authorized Boeing's then CEO Philip M. Condit and then-McDonnell Douglas CEO H. Ross Perot to meet and narrow their key differences at a pl

Seattle hotel. After forty-five minutes, the two agreed on everything, including the merger price. But Boeing execs criticized Condit for not having a lawyer present, rightly fearing that Stonecipher had won more concessions. Newhouse quotes former senior Boeing executive Gerald King, one of the architects of the merger, as saying that "the Boeing side wanted to have as little to do as possible with Stonecipher," who was viewed as prone to milk assets and overreluctant to invest in new products. The deal had the unforeseen consequence of making Stonecipher the second-most-powerful executive at the new Boeing, positioning him to assume the No. 1 spot when Condit resigned in 2003.

Another absorbing chapter focuses on Jean-Pierre Pierson, the legendary former CEO of Airbus

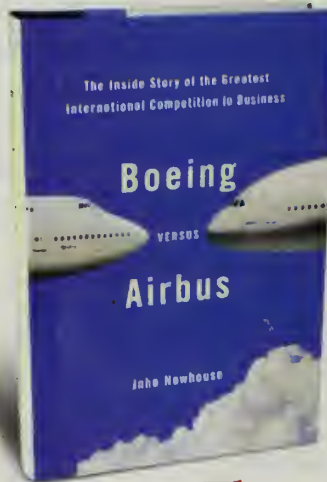
during its most successful growth spurt. The section draws upon one of the few extensive interviews the Frenchman has granted since his 1998 retirement, in which, among other things, Pierson recounts various sales battles. In 1997, for example, he was engaged in negotiations with Steve Wolf, then the CEO of US Airways, over the purchase of 130 A320 aircraft. At the very end, Wolfe demanded an additional 5% discount. In

The success of Boeing's 787 over the Airbus A350 helped turn the tide

response, Pierson recalls, he began slowly lowering his trousser saying: "I have nothing more to give."

Such fly-on-the-wall stories are among the strengths of *Boeing Versus Airbus*. Newhouse also is particularly good in describing the role of government in the aircraft industry. On the other hand, he tries to cover too much ground. All the same, *Boeing Versus Airbus* is a must-read for anyone looking for a glimpse into the white-knuckled world of the commercial airplane business. ■

—By Stanley Holt



ONTARIO HAS BEEN GRANTED MORE PATENTS THAN SWEDEN, SWITZERLAND, OR AUSTRALIA.

Ontario has always done its part to keep the U.S. Patent Office working overtime. Canada as a whole ranks eighth in the world in the number of patents granted, almost half of which originated in Ontario. Many great innovations were developed here, in technology, automotive and life sciences. And the pace of innovation continues into genomics, robotics and holography. Innovation comes naturally in Ontario because our 44 universities and colleges produce the highest ratio of university-educated workers; 56% have a post-secondary education, the highest rate in the industrialized world. In fact, our spirit of innovation and quality of life also attract renowned scientists, researchers and engineers from around the world. Our approach to business is equally innovative. We are committed to commercializing groundbreaking science with generous R&D tax incentives, public research institutions, and economic strength attractive to investors. In a knowledge-based economy, Ontario's belief in innovation is one of a kind. There's no better place in the world to do business.



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BY FRED KRUPP

Grab the Green Brass Ring

As Europe moves to profit from the world's next great economic transition—the emerging low-carbon economy—the U.S. faces a stark choice: learn from Europe's experience and fully join the race to find market-driven solutions to combat climate change, or surrender the new century's most important generator of jobs and wealth to our transatlantic competitors.

Thankfully, momentum is gathering for a shift in the way the U.S. generates and uses energy. This week, 10 leading corporations, including General Electric, Alcoa, and Caterpillar, joined environmental groups in a bold call for a market-based cap on America's total carbon emissions. There's also a buzz in the new Congress, and climate change is a hot topic at the annual gathering of financial leaders at the World Economic Forum this week in Davos, Switzerland. So it's a good moment to take a closer look at Europe's experience using markets to fight global warming.

The European "cap and trade" market sets carbon emissions limits for 11,000 facilities, and it allows those who beat their targets to sell their surplus allowances. Although it's only a pilot (the full program kicks in next year), the market has already drawn billions of euros into innovative, low-emitting energy strategies. Without a comparable U.S. market to spur private investment in low-carbon fuels and equipment, our technology will certainly lag, and America will end up having to import the new green technologies, just as we now have to spend our national wealth to import—and defend—foreign oil.

ODDLY ENOUGH, THE EUROPEANS modeled their system on the strikingly successful U.S. acid rain program, which caps sulfur dioxide pollution from all electric utilities and lets those that cut pollution swiftly sell spare allowances. In the U.S., that has spurred a healthy competition to find better, cheaper, faster ways of cutting pollution and has shown the power sector as a whole that it can be a pollution-control overachiever.

To encourage more countries to dip a toe in the carbon market, however, the Europeans also let their emitters buy carbon credits from projects in developing nations where there are no emissions caps. That's a risky move. Without national caps, a project can't generate credits unless it proves it has cut carbon below what would have been emitted anyway. That siphons off a substantial portion of

the investment into consultant fees, crowding out all but the highest-margin projects. More important, these traders don't really cut global emissions; they just move business as-usual emissions from poorer countries to richer ones. The Europeans are starting to recognize this inherent contradiction, and trading within Europe has recently begun growing faster than trading with uncapped countries.

That's the untold story: Despite initial reports to the contrary, emissions data show European companies really are cutting carbon, according to a Massachusetts Institute of Technology study—and faster and more cheaply than predicted. Sales of future years' emission permits are fetching higher prices,

reflecting the market's expectation that carbon caps will tighten further. And money is pouring into innovative technologies because the market has finally put a value on low-carbon results.

So, the question is no longer just how to avoid the catastrophic impacts of climate change, but which nations will produce—and export—the green technologies of the 21st century. The stakes are huge. Worldwide, clean energy transaction topped \$100 billion in 2006, up 43% from 2005, according to London-based New Energy Finance. And since developing countries will need \$160 billion in electricity sector investment each year just through 2010, according to the World Bank Group, though the lion's share of the nearly \$100 billion in carbon market activity to date has been

in Europe, there still should be room for newcomers.

Historic transitions—from the Industrial Revolution to globalization—are never without dislocations and disruption, and Europe's pilot carbon-trading program has had its share. But the real lesson from Europe is that the economic winner of the 21st century will be those who grasp low-carbon's inevitability, and act quickly to capitalize—and capitalize on. Indeed, without a U.S. carbon cap and trade system that draws on Europe's successes and its missteps, we will be unprepared for forces already reshaping the global economy. ■

Fred Krupp is president of Environmental Defense, a New York environmental advocacy organization.

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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Succession Opportunity

I run a small company, and it's time to pick a successor. I can make the case for any of four people. Now what? Losing someone could hurt.

—Michael Rueckert, Sioux City, Iowa

You have a rare and wondrous problem. Indeed, the exact opposite of the usual case, in which companies find themselves empty-handed at succession time, and, in desperation, are forced to back up a Brinks truck to pay for an outside hire. So, first of all, congratulations on building a leadership team with such bench strength.

But we understand your concern; you've got four stars and only one top job, plus the sinking feeling that your small company can't take an exodus of its most experienced managers. Your instinct is probably to forge some kind of compromise solution, picking one person and giving the others job titles and money to stick around in support roles. That approach can work, but if your candidates are who you think they are, the likelihood of all of them staying put is, well, low. Few real leaders are satisfied with second-tier roles or maintaining the status quo.

And, in fact, your goal right now shouldn't be downside protection. It should be finding the person who can take your company to the next level. You may feel as if you have four great candidates, but it is highly unlikely that they are interchangeable. Not all of them have the "stuff" for the challenge ahead, meaning the kind of insight and courage that will be required to reinvent your organization when you step aside. You need to push yourself to identify the single candidate who does.

Will that move prompt the runners-up to leave? It's very possible, due to feelings of disappointment or embarrassment. But don't focus on that too much. Their departure will actually be a favor—for them and the company. For them, because it certainly sounds as if they earned the right to run their own shows, and they deserve the challenge and fun of it. And when other companies show up to "steal" them away, make sure their severance packages are generous and contain some form of noncompete clause. That will help everyone.

Their departure will be a favor to your company because, in our combined experience, keeping failed candidates

around is too often disastrous. Each candidate's sense of letdown, compounded by the bad vibes of his or her followers, enervates the organization. By contrast, if the runners-up go, you can reach into the teams they surely built along the way to find replacements. These new managers may not come as "fully loaded" as their predecessors, but they will probably be bursting with new ideas and positive energy.

Basically, you don't have a problem as much as an opportunity. With four candidates to choose from, you're guaranteed to pick a successor who will hit the ground running. Yes, there may be an initial jolt to the company when one or two of the runners-up depart. But soon enough the change will open the doors of their careers and bring fresh air through your own windows, too.

My team has been forced to put up with an incompetent manager for two years. I spoke to the regional head and was they were "working on it." That was six months ago. I don't want to be seen as a whiner, but I am thinking of going to the CEO to get some action. Your opinion?

—Anonymous, Atlanta

If you take your case to the CEO, you'll get action all right! And that sound you'll hear is the collective groan of everyone who has ever watched in wonder as some poor, naïve soul tried to pull an end run. In fact, the fate of people who go to their boss's boss to complain is so well-known that we would be reluctant to answer your question—if we didn't get one just like it virtually every day. Sure, the details are different but the final quandary is the same: I'm frustrated with my boss. Can I break rank?

For the record, the answer is usually no—unless you have a big safety net or another job in hand. End runs backfire 80 to 90% of the time. Few bosses reward people who sneak around the organizational chain of command. Moreover, most companies are painfully aware of bad bosses and struggle to find a way to force them out. Shoving that point in their face won't make you a hero; it will make you an annoyance.

If you dislike your boss so much that you are ready to burst, you really have only two foolproof choices: Wait it out or walk out. Most end runs only end you. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm. To watch a video interview with Jack and Suzy answering this week's questions go to www.businessweek.com/go/tv/welch.

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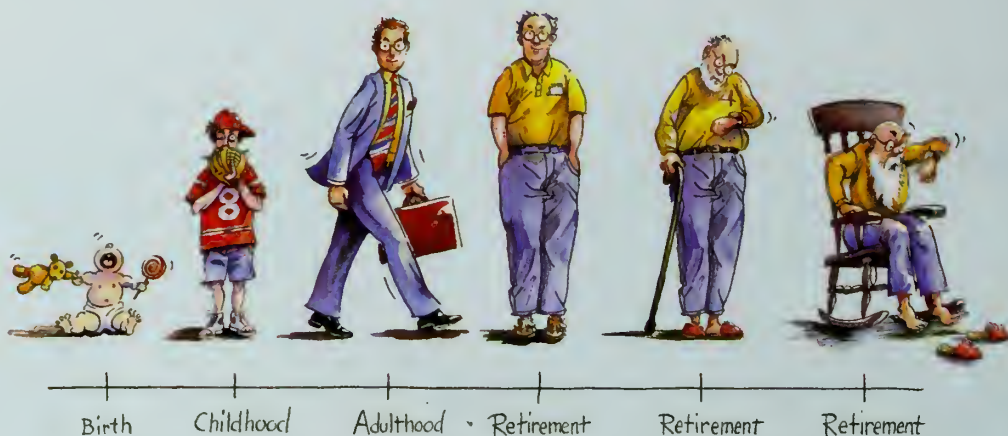
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The generation that wouldn't trust anyone over 30



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Average life expectancy in the U.S. has risen to an all-time high. Great news, except that the amount of money people put away for retirement isn't rising at all. How is our nation going to make sure its citizens have the money to retire? Allstate has a few ideas:

1. EXAMINE SOCIAL SECURITY

Americans will not be able to rely solely on Social Security for a comfortable retirement. In the future, it's projected to cover an increasingly smaller percentage of the average retirement. There's debate as to whether it should be repaired or replaced. But what's clear is we need to reform Social Security now.

2. BOOST RETIREMENT PLAN ENROLLMENT

Companies should continue looking for ways to encourage employee participation in 401(k) plans. One proven method to increase retirement savings is

through company matches. Another is automatic enrollment—employees are signed up for savings plans when they join the company, unless they specifically opt out.

3. INCREASE PERSONAL SAVINGS

Ultimately, everyone is responsible for their own retirement. It's why we support laws that reward people for saving. Tax-advantaged savings programs, like annuities and IRAs, are two examples. These strategies can help allay Baby Boomers' biggest fear: living to see the well run dry.

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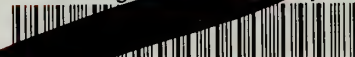
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Carlyle Steps Into The Light

How the once-secretive
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changing the buyout game

BY EMILY THORNTON (P.46)

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HOW NOT TO ANNOY THE NEW
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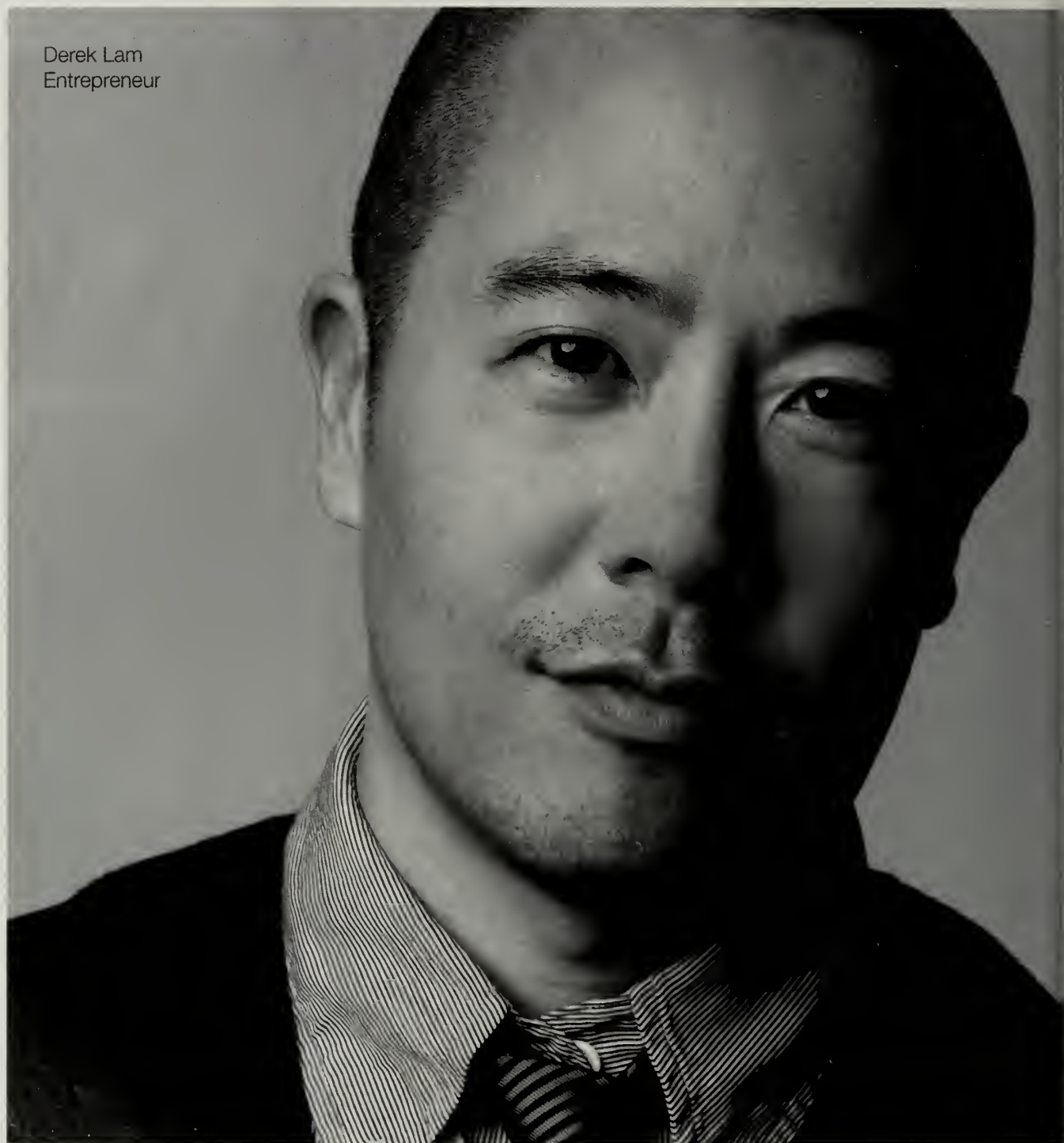
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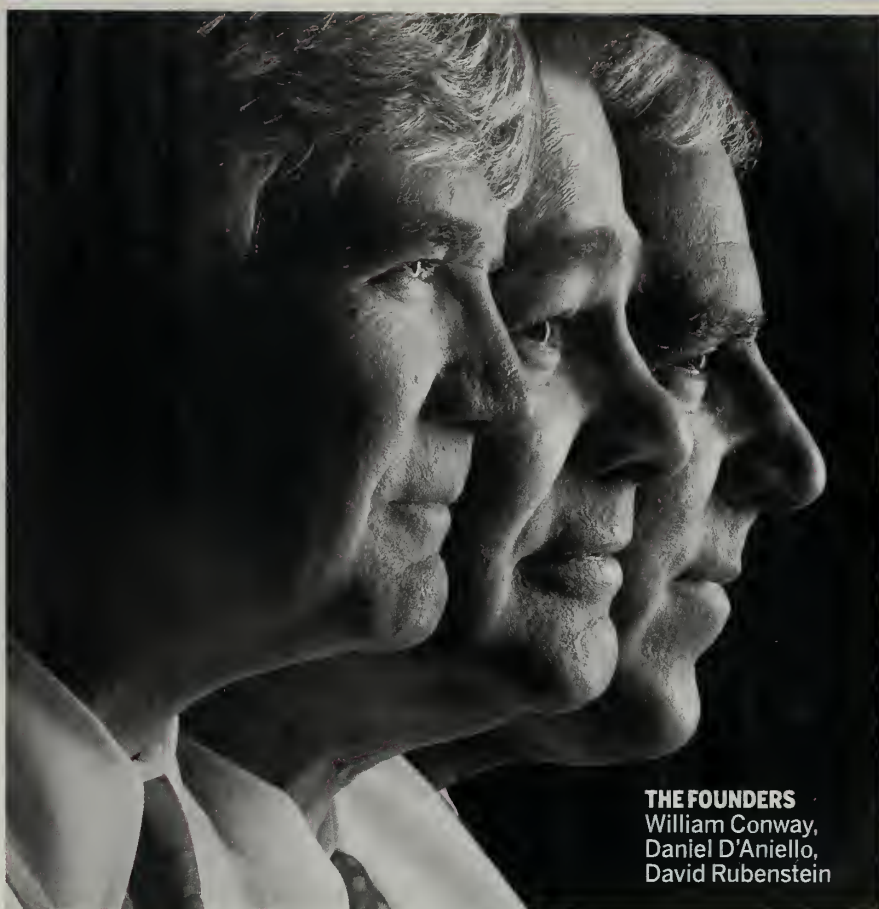
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Cover Story

46 Carlyle Changes Its Stripes The once-secretive buyout firm long known for its political connections and holdings of defense contractors is diversifying into a broad range of assets and deals, and changing the rules of private equity. Already the world's biggest fund-raising machine, it expects to have a record \$85 billion under management by yearend.



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Hot stuff:
Target is
one of our
top stocks

Your Best Market Plays

Don't count on a repeat of the juicy stock market returns of 2006. There are signs that the new year may be less rewarding for equity investors: **Corporate profits** could slow from their double-digit growth rates; experts expect economic growth to moderate from last year's pace; and inflation remains on the radar screen, with energy-price moves a wild card. Amid the uncertainty, BusinessWeek.com's special report on the **Top Stocks for 2007** focuses on individual stocks that are well-situated no matter which way the winds are blowing. BusinessWeek.com reporters set out to pick the brains of top Wall Street analysts, collecting their outlooks for six key sectors, along with their best investing ideas. Our stories on **the best plays** in energy, financial services, health care, real estate, retailing, and technology size up the prospects for each sector in the coming year. And be sure to view our slide show featuring the cream of the crop—top picks from each of the sectors surveyed in our report. Go to www.businessweek.com/07/topstocks for all this and more.

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"Something that is forgotten in all of this is people like to smoke."

—Morgan Stanley analyst David Adelman on the strength of tobacco stocks as Altria, whose shares have nearly doubled over the last six years, prepares to spin off the far weaker Kraft, as reported by The New York Times.

EDITED BY DEBORAH STEAD

HOT SEATS

Excuse Me, Mr. Chairman ...

SO YOU'RE AN EXECUTIVE who has just received a call to testify before the new Democratic Congress. Other than calling your lawyer or spiritual adviser, what should you do? The first rule: Prepare for the worst. "If they thought you'd done everything right, you wouldn't be there," says

one former Hill staffer. The second, important for executives accustomed to calling the shots: be deferential. Beyond that, it's helpful to know your interrogator. Here, a few tips for dealing with some of the new committee chairmen CEOs might find themselves facing. —Richard S. Dunham

Representative Barney Frank (D-Mass.)

House Financial Services Committee

» Be succinct. Frank has no tolerance for witnesses who are undisciplined with words. On the other hand, he's willing to hear details about, say, how businesses are doing something about the need for affordable housing.

DON'T get into an argument with him—unless you enjoy public humiliation. Born in Bayonne, N.J., and educated at Harvard, Frank is one of the sharpest tongues and smartest minds in Washington.

Senator Christopher Dodd (D-Conn.)

Senate Banking Committee

» Talk bipartisan solutions. Dodd works closely with the committee's top Republican, Richard C. Shelby of Alabama. He's gregarious, so a pre-gavel handshake or pat on the back can improve the atmosphere.

DON'T even think about hinting that the hearing will help his 2008 Presidential bid—or trying to win a battle of quips. Dodd is considered the quickest wit in the Senate.

Representative Henry Waxman (D-Calif.)

House Government Reform & Oversight Committee

» Make a case for why your company is a stellar corporate citizen, notwithstanding the little controversy in which it now finds itself.

DON'T challenge the hearing's premise. The event is scripted by one of the Hill's best staffs. Remember Waxman's famous 1994 hearings, when tobacco execs swore under oath that nicotine wasn't addictive? Big mistake.

Senator Joseph Biden Jr. (D-Del.)

Senate Foreign Relations Committee

» Feel free to flatter him. And remember that he uses Amtrak to commute to work from Wilmington. He likes execs who take public transit.

DON'T interrupt him while he's interrupting you. He enjoys talking. Let him. It means less time for you on the hot seat. And unless you want a tongue-lashing, "don't correct him," says Dallas-based Merrie Spaeth, who has coached witnesses.

Representative John Dingell (D-Mich.)

House Energy & Commerce Committee

» Acknowledge the problem; describe your plan to fix it. The 80-year-old Detroit lawyer is tough. He sees himself as a gentleman, though, so introducing yourself earlier may pay off.

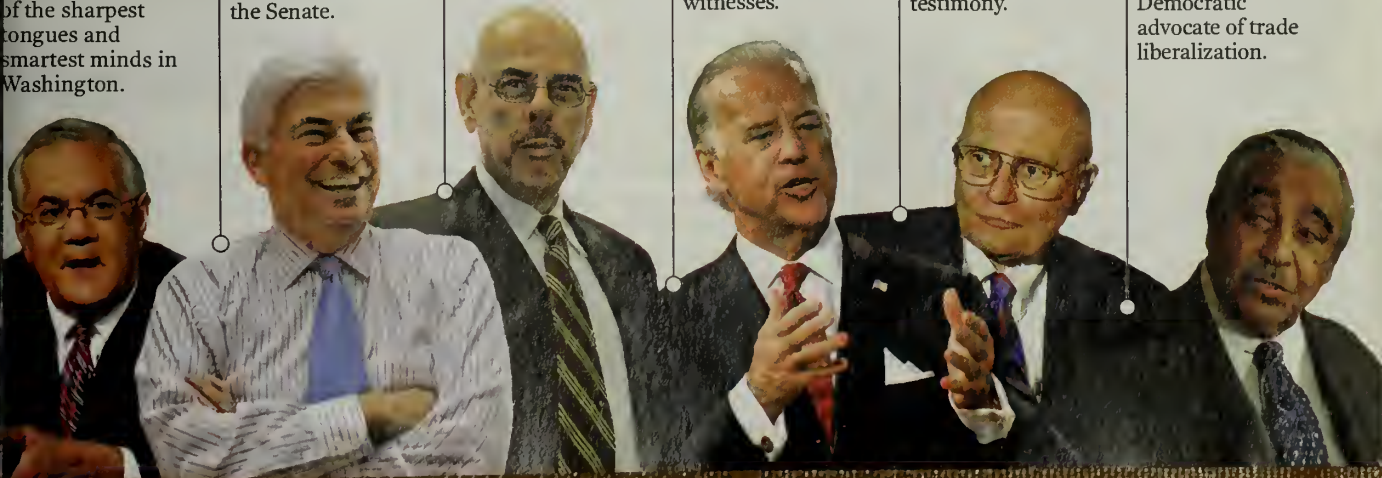
DON'T say, "I don't recall." Dingell berates witnesses who claim weak memories. And don't try spinning your way out of a mess; he probably knows about that internal memo that contradicts your testimony.

Representative Charles Rangel (D-N.Y.)

House Ways & Means Committee

» Tell a story or use an example with a New York angle. The 18-term lawmaker from Harlem is very hometown-centric.

DON'T assume just because he has a liberal record that Rangel is antibusiness. He wants to hear how companies are creating jobs that move people out of poverty. And while he's a close friend of organized labor, he's nonetheless a leading Democratic advocate of trade liberalization.



NAME DROPPING



BUFFETT: THE SILENCE OF THE SAGE

In the world of investing books, a title using the words "Warren Buffett" is best-seller bait. But Buffett himself stays on the sidelines of such enterprises. "There are so many books," he told *BusinessWeek* recently, "I don't cooperate with them, and I don't put up roadblocks. I'm not part of the act." That includes books by Mary Buffett, his former daughter-in-law, whom he hasn't seen since she divorced his son in 1993 after 12 years of marriage.

With her inner-circle cred, Mary has built a franchise in writing and speaking about the legendary investor, most recently with *The Tao of Warren Buffett*. She says she gets fresh insights by reading, talking to family friends, and working with Omaha-based co-writer David Clark. She also fondly remembers Buffett's dinner-table maxims. (Sample: "It's easier to stay out of trouble than get out of trouble.") Warren Buffett's own literary efforts center on his yearly Berkshire Hathaway letter to shareholders, the latest of which he's writing now. "My annual report is my book," he says. "I'm at 13,700 words."

—Diane Brady

TOXIC TRASH

NO EXIT FOR THE GLOWING RED SIGNS

DAVID LOCHBAUM, a safety engineer at the Union of Concerned Scientists, believes he has identified a grave radiation threat—and it doesn't arise from his usual targets, nuclear power plants. The danger, Lochbaum says, comes from exit signs. The ubiquitous signs (100,000 sold annually in the U.S.) contain tritium, a radioactive isotope of hydrogen. Yet the signs are being discarded into ordinary landfills.

Tritium allows exit signs to glow in the dark without any power source. In landfills, Lochbaum says, the isotope, a known carcinogen, can percolate into an area's drinking water. "If the runoff isn't monitored," he says, "the first sign of trouble could be people getting sick and dying."



Tests have turned up high levels of tritium in the leachate, or liquified waste, of almost all of Pennsylvania's 59 landfills, sometimes at more than six times the EPA limit. That finding alarms state regulators, who asked the U.S. Nuclear Regulatory Commission for tougher policing. (On Dec. 7, the NRC "reiterated" rules that require old exit signs to be taken by licensed haulers to special radioactive dumps.)

Washington, says Thomas Fidler, a top Pennsylvania radiation protection official, gives "so much attention to contamination from power stations while overlooking this." State authorities say they may petition the feds to compel stronger action.

For now, disposal companies, whose officials think the risk from tritium is minimal, have agreed along with other operators to measure tritium at Pennsylvania landfills for the next two years.

Bill Rowan, sales director for Isolite, a Berwyn (Pa.) exit sign company, says the threat is "totally overblown. Who drinks leachate?" But the NRC, charged with protecting Americans from radioactive materials, acknowledges the disposal problem. "Tracking the origin of a tritium exit sign that ends up in a landfill is difficult," says spokesman David McIntyre. "That makes enforcement difficult."

—Keith Epstein

EXPENSING OPTIONS

THE BIGGEST BACKDATERS (SO FAR)

JUST HOW MUCH has the options backdating scandal cost business? So far, some 70 companies have restated earnings, logging a total of \$9.9 billion in additional expenses. Broadcom tops the list with \$2.2 billion in pretax charges. Costs at other companies have been

far lower: For all the attention centered on Steve Jobs and his company, for example, Apple's earnings were restated by only \$105 million. What accounts for such differences? The number of backdated options is one factor,



says Todd Fernandez of proxy advisory service Glass Lewis. Another: the difference in the stock price between the day an option was truly granted and the false date at which it was recorded. The bigger the attempted gain from backdating, the bigger the expense now. Here, the 10 biggest pretax charges for backdated options.

—Jane Sasseen

COMPANY	CHARGES FOR BACKDATED OPTIONS (MILLIONS)
Broadcom	\$2,200.
UnitedHealth Group	1,642.
Juniper Networks	900.
Mercury Interactive	574.
KLA-Tencor	400.
Brocade Communications Systems	349.
CA	342.
Monster Worldwide	339.
Tyco International	252.
VeriSign	250.

Data: Glass Lewis &

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STORM KIT

CRANK UP THE FORECAST, MA

FLAT-PANEL TVs, the Wii, and...wind-up radios? This past holiday season, retailers say, crank-powered flashlights and radios were strong sellers. With bizarre weather gripping the country, forecasters, the Red Cross, and retailers themselves talked up self-



powered gadgets as a key to emergency preparedness.

RadioShack says weather worries are driving sales of the three crank radios it offers. And Morris Mitchell, president of the men's

division of **Tandy Brands Accessories**, reports that sales of its **Totes** brand crank-powered flashlights, cell-phone chargers, and radios (below left) to stores such as **Macy's** and **J.C. Penney** have tripled in the wake of Katrina, to 750,000 units. Customers, he says, are buying them "five or six at a time for their families, friends, cars, and homes."

Also selling well: a co-branded line of crank- or battery-operated radios launched by the **American Red Cross** in partnership with **Etón**, a Palo Alto (Calif.) electronics manufacturer that also credits rising interest in renewable energy for the radios' popularity. The Red Cross says sales are positive enough to trigger plans for it to license more self-powered gadgets, including foot-crank generators.

—Elizabeth Woyke



DOWN UNDER DEVILS' ADVOCATES

LIKE ITS cartoon counterpart, Australia's Tasmanian devil is all screech and not much bite. **Despite its fier appearance, the marsupial scavenger is more koala than killer—likely to share a carcass peacefully,** says Nick Mooney, an Australian wildlife biologist. Sadly, that sociability is contributing to the devils' demise. In just 10 years, a highly communicable, fatal form of facial cancer has halved the population. And as devil disappear, non-native foxes and feral cats invade, which could mean a cascade of extinctions. To help find a cure and rescue the Taz—the inspiration for its Looney Tunes star—Warner Bros. is lending a hand with the sale in Australia of a special-edition plush Taz toy for about \$39. All proceeds go to the conservation work of the Tassie Devil Appeal.

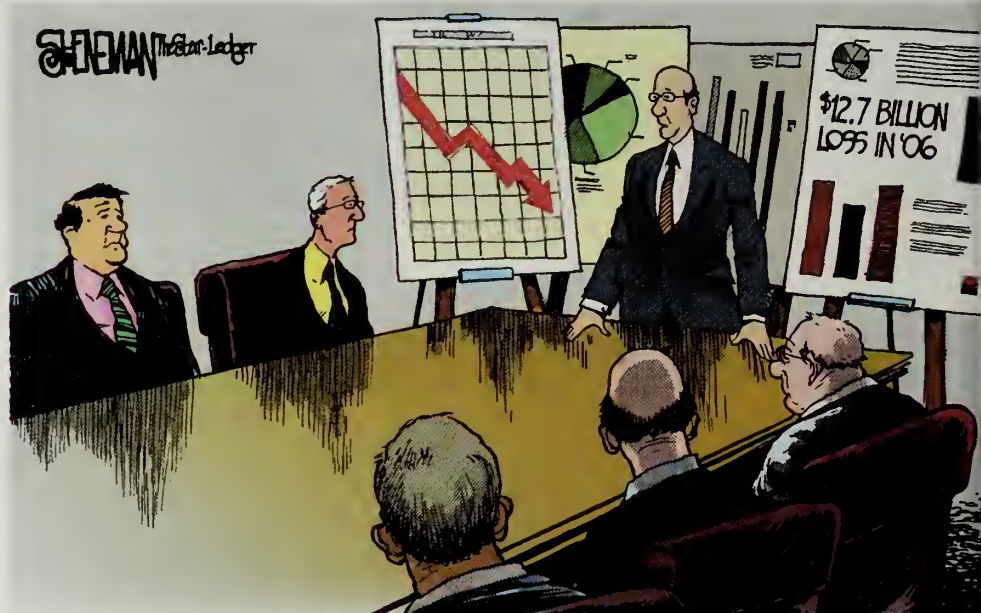
—Adam Astor

BLOGSPOTTING NUMBER CRUNCH

10qdetective.blogspot.com

» TO READ SEC filings with a guide, go to this blog run by David Phillips, an investment newsletter publisher. He focuses on financial-statement "soft spots," such as restructurings, and also takes on issues like executive pay, recently analyzing the actual compensation of \$1-a-year CEOs like Yahoo!'s Terry Semel and Apple's Steve Jobs. Phillips delves into the data and lets others handle the witty asides, sprinkling in lines from movies and songs. On the payoff to shareholders from Semel's low official salary, he paraphrases Tom Waits: "The big print giveth and the small print taketh away."

—Lindsey Gerdes



"IN ADDITION TO THE RESTRUCTURING, WE'LL BE CHANGING OUR SLOGAN FROM THE CURRENT 'FORD: BOLD MOVES TO 'FORD: FOR THE LOVE OF GOD, JUST BUY ONE.'"

When he has the time,
Pete works on his
idea for an application
that would allow
seamless collaboration
between offices.

But he spent most of
today riding in the
elevator between his
office and the data center.

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PETE ANDERSON
IT SPECIALIST

2

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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

When 'Get Well Soon' Isn't Enough

At the small company where I work, the CEO is quite ill. Although he is obviously suffering, he still comes to the office, where much of the time he can only rest. We all admire his courage, but we're beset by fears that he'll have a medical emergency—or even die—here. Meanwhile, crucial tasks are falling through the cracks. Can you suggest an approach to this delicate problem?

—Anonymous, New York

WHEN IT comes to dealing with the debilitating illness of any employee, let alone a CEO, many people—both managers and workers—are at a loss. They either become tongue-tied in the presence of the ailing colleague or mutter something like “hope you’re feeling better”—expressing their real feelings or worries instead to others, in whispered, albeit well-intentioned, conversations.

It can be an enormous relief if the sick person makes it clear that it's O.K. to talk openly about the situation. But a business can't count on that. An employee already burdened with health woes may not have the energy to bring up the subject. Or, in the case of a CEO, it just may not be part of his or her makeup. Some of the most adaptive aspects

of a CEO's personality—feelings of strength and invulnerability—may make him or her more liable to deny the severity of an illness.

So it's usually up to the staff to break the ice. And when the ailing individual is a key member of that staff, the matter takes on some urgency. This is especially true in the case of a CEO at a small company, where you don't have directors and where the enterprise can feel a lot like a family (one whose parent can no longer provide needed guidance).

RAISING the issue with your CEO will take courage and sensitivity. You may even feel guilty about asking him to think about the business, given his health crisis. The chances are, though, that he won't feel it's inappropriate. He has demonstrated by his daily presence that the company's smooth functioning still matters a lot to him.

How to begin? Consider forming a small group of employees who are close to the CEO. You might also include a family member for advice, if that seems appropriate. After

picking a spokesperson (you don't want your chief to feel ganged up on when he's so frail), ask for a meeting. The designated talker should acknowledge the difficulty of the conversation, then tell the CEO that the staff would like to enlist his help in dealing

with their concerns about his illness and the effect it's having on the business. Tell him the truth: The staff is having trouble focusing on work. There's also a leadership vacuum. Could he appoint someone to be in charge, even temporarily so he can focus on taking care of himself? Say all this with warmth and caring, and you might be surprised at how much he

appreciate your concern. It might even help him deal with his illness. You owe it to him and the company to speak up. Otherwise, the health of the business will be in peril, too.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send him questions at analyzeethis@businessweek.com.



QUESTION OF THE WEEK

What surprised you most at this year's World Economic Forum in Davos?

“The biggest surprise was how Doha [the stalled Doha Development Round of WTO negotiations] moved from the bottom to the top of the agenda. The business leaders here got together to help get the trade talks revived.”

E. Neville Isdell,
Chairman and CEO, Coca-Cola

“I was surprised by John McCain. I had heard about his short fuse. But during a small group discussion, I questioned his position on Iraq, and he bit my head off.”

Arianna Huffington,
Editor-in-Chief,
HuffingtonPost.com

“I found Davos more optimistic than last year. The American economy is strong. There's still huge interest in China and India—though more in India! And all this is happening despite huge cynicism about the Iraq war.”

Azim Premji,
Chairman, Wipro



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Find out how to improve your sleep habits at www.lunesta.com. Or call 1-800-Lunesta.

IMPORTANT SAFETY INFORMATION: LUNESTA works quickly, and should be taken right before bed. Be sure you have at least 7 hours to devote to sleep before becoming active. Until you know how you'll react to prescription LUNESTA, you should not drive or operate machinery. Do not use alcohol while taking LUNESTA. Most sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. See important patient information on the next page.

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Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if

you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice

any changes in your behavior, or if you have any unusual disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potent effects in the unborn baby when used during the last weeks of pregnancy. Be sure to tell your doctor if you are pregnant if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of small amounts of LUNESTA on an infant are not known; therefore, as with all other prescription sleep medicines, recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any other sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may be taking, including medicines you may buy without a prescription and herbal preparations. You should tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get at least 7 more hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, if you become pregnant, or if you are breastfeeding a baby while taking LUNESTA.
10. As with all prescription medicines, never stop taking LUNESTA or any other sleep medicine without consulting your doctor. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it with or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the lower dose (1 mg) of LUNESTA. Your doctor will choose to start therapy at 2 mg. In general, adults under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or break the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

Rx only



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“ [For Howard Stern], there is no better revenge than an \$83 million bonus on top of \$100 million base pay in 2006.”

—Lincoln Merrihew
Northborough, Mass.



REVENGE IN BUSINESS: HANDLE WITH CARE

“SWEET REVENGE” (Cover Story, Jan. 22) reminds me of advice given by basketball legend Bill Russell: “Select your enemies well. One day you will be just like them.”

—Alec Hill
Madison, Wis.

IN A FORMER workplace I had a chance to undermine a co-worker who’d previously earned my dislike. Due to a computer malfunction, a 100-page document she was composing vanished. The loss guaranteed she’d never make her deadline.

I watched her stress mount for a moment or two, but I couldn’t resist pointing out something she didn’t know. She’d accidentally CC’d me a recent draft of her document. Relief washed over her as she realized she’d make her deadline after all.

Why did I do that? I guess having whiffed the dregs of retribution, I realized something George Orwell once wrote: “Revenge is sour.”

—Timothy Chambers
West Hartford, Conn.

IT’S FITTING that your cover story on revenge is in the same issue that notes

Howard Stern’s second-act success (“Stern’s Latest Bonanza,” The Business Week, Jan. 22). For all the flak he got for jumping to satellite and all the verbal barbs he took from rivals over his initially smaller audience, there is no better revenge than an \$83 million bonus on top of \$100 million base pay in 2006.

—Lincoln Merrihew
Northborough, Mass.

LIKE MANAGERS ACROSS the U.S., I’ve been pulling together annual performance appraisals for my employees. Needless to say, your article on revenge was timely. The last thing I needed to read were details of retribution, spite, and loathing from unhappy employees. It reminds me of advice from an ex-human resources mentor before annual appraisal season: “Don’t forget to install your remote car starter.”

—Michael L. Puldy
Superior, Colo.

I WAS EXTREMELY disappointed that you chose revenge as the topic of your cover story. Surely, with the unparalleled pace of change and the challenges of the business world today you could have found a more progressive subject that

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reflects this change and the thinking of modern management gurus.

Revenge is about short-term gain at the expense of long-term health. Whatever happened to doing the best you can because of your own standards? Didn't your mother ever tell you that the only competition is with yourself?

—Lou Schwartz
Scottsdale, Ariz.

HOW TO MAKE SURE 'NEW' HOME LISTINGS REALLY ARE NEW

REPEATEDLY LISTING AN overpriced house as "newly listed" is not illegal. However, it is unethical ("New listing! (sort of)," *News & Insights*, Jan. 22).

If a seller is not willing to sell a house or property for market value, it should be taken off the market indefinitely. The free market should not be manipulated by broker shenanigans. Buying a house is the most important and expensive decision most consumers will make.

Real estate agents need to start policing themselves or run the risk of being regulated. Perhaps part of the titling system should involve a unique, permanent Multiple Listing Service number that is assigned to a particular house and is used

every time it is bought, sold, or listed. That way, brokers would have one less way to dupe honest, trusting home buyers.

—Charles E. McCannon
Darlington, Md.

EMC HAD 'A VERY GOOD YEAR'? NOT BY THE STOCK PRICE

"EMC: A FRESH tech star" (*Inside Wall Street*, Jan. 8) included a paragraph stating: "It was a very good year." In fact, it was a terrible year. On Jan. 6, 2006, EMC closed at \$13.72. The article refers to a current price of \$13.47—in a year when average equities averaged double-digit advances.

—Kent Van Allen
Lynchburg, Va.

IF INDEXES ARE THE BEST BET, WHY KEEP PUSHING MUTUAL FUNDS?

IN "OUTSMARTING the market" (*Special Report*, Jan. 22), you say the lesson of Barclays Global Investors' brainy work is that the average investor should "Get thee to an index fund. Now." You also state that the Standard & Poor's 500-stock index has outperformed 71% of large-cap managed mutual funds over the past five years.

So why does *BusinessWeek* continue to regularly feature best-investment articles that list performance histories of mutual funds? If past performance indeed not a predictor of future performance, and if only about 30% of funds can be expected to outperform the index anyway, are you not doing your readers a disservice by offering them what at best amounts to nothing more than a drive and at worst steers them in a dangerous direction?

—Dan Roth
Fountain Valley, Cal.

SIMPLE, PLEASANT WINES DESERVE MORE PLAUDITS

WHILE I HAVE great respect for those who earn a living critiquing wine, I often find it hard to take some of the overblown pronouncements, such as "pinot noir...is of little interest" ("The pinot noirs live up to the hype," *Executive Life*, Jan. 22).

As someone who has derived pleasure from drinking wine for more than 40 years, though I still enjoy the complex Bordeaux in my cellar from the 1970s and '80s, I truly love the simple, pleasant, easy-to-drink wines from the C

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Riverside Walk on the Thames

Beauté, the Beaujolais, and the lightful Sangioveses from Tuscany, to nothing of the pinots from Carneros, which I have relished for 20 years. These put-downs are something I have long resented and ignored as nose-they-air, holier-than-thou, irresponsible statements for an audience with which I am not familiar.

—Mark Wittels
Oro Valley, Ariz.

MEDICAL STUDENT FENDS HIS MENTORS

OUR BOOK REVIEW of *Coronary: The Story of Medicine Gone Awry* ("Open-heart nightmare," Books, Jan. 22) unfairly portrays Stephen Klaidman's unfortunate account as endemic in a profession with an "all-too-frequent association with medicine and profit-mongering." It gives the reader with the "stark and enduring lesson" of considering a second opinion when seeking medical care, as to say that many (if not most) doctors will be motivated by profit at the expense of patient care.

As a student at Harvard Medical School and a frequent observer of what goes on in many of the hospitals in the

Boston and New York areas, I find this portrayal to be grossly inaccurate.

Virtually all the health-care providers I have met and worked with are clearly honest, humanitarian individuals with a sincere desire to help those in need, even at the expense of extra profit. Cardiologists, gastroenterologists, and orthopedic surgeons alike will dependably opt to medically manage their patients, when indicated, even if this means no invasive procedure and therefore less money.

Many of my classmates, in fact, had the opportunity to work for hedge funds or investment banks but went to medical school instead because they wanted to be healers, even though they knew they would not earn as much money as they would have if they had entered the business world.

—Yehoshua C. Levine
Brookline, Mass.

WHERE TO FIND OUT WHICH FUNDS ARE OPEN FOR BUSINESS

"MEET THE FUNDS that perform" (Personal Finance, Jan. 22) looked good at first blush, but when I looked up the A-rated funds in the foreign category, 12 of the 14 were closed to new investors.

To put it mildly, this is not very useful for an individual investor who is trying to find a good fund. How about also listing the open/closed status as well?

—Mike Kwan
Sunnyvale, Calif.

Editor's note:

For an updated list of which mutual funds are open and which are closed, please go to www.businessweek.com/extras.

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Turbocharging the Tablet

Since its much hyped release more than four years ago, the Tablet PC has been mainly a curiosity, popular on some college campuses and in a few industries and ignored everywhere else. The software, Windows XP Tablet PC Edition 2005, wasn't very good, and the Tablets themselves were short on performance. Windows Vista has changed that in a big way.

The Tablet software, which lets you replace the mouse and keyboard with a pen and allows you to write or draw directly on the screen, gets two critical improvements in Vista. First, handwriting recognition actually works, meaning that you rarely have to resort to the clunky on-screen keyboard. Second, Microsoft has finally realized that a pen is different from a mouse. When you're working with the pen, a little dot on the screen tells you where the pen is pointing, rather than a big mouse arrow that gets in the way. And you can use pen-stroke gestures—Microsoft calls them flicks—for common navigation and editing moves. For example, a quick upward flick on a long Web page moves it up, as though you had spun the wheel on a scroll mouse. A flick to the upper left will delete a selection.

Computer makers are responding to the improved software with some interesting hardware. I tried out three new and very different "convertibles," or Tablet laptops that can be used in either the conventional clamshell mode or with the screen folded over the keyboard to form a slate. All of them are very compact and weigh in at just under 4 lbs.

THE TOSHIBA PORTEGE R400 IS A CLASSIC example of a Japanese executive prestige PC. With a starting price of \$2,599, it features an array of bells and whistles, including a screen on the edge of the case that can display new e-mails or calendar items while the laptop is closed and what Toshiba bills as the first wireless docking station using a new radio technology called ultrawideband. The Portégé's main display is a 12.1-in. widescreen. The screen is very bright, but for typical Tablet use, I think an anti-reflective coating would be better than its polished finish. The computer should get about 5 hours of battery life, and twice that with an auxiliary battery that adds 15 oz. Both in laptop and slate mode, the Portégé is a nice piece of work.



The Hewlett-Packard Pavilion TX1000 Entertainment Notebook is something completely new: a Tablet, starting at \$1,299, aimed at consumers. Its dimensions are similar to Toshiba, and while it lacks frills like the Portégé's external display, it has one feature the R400 lacks, a DVD drive.

All Tablets that I have seen to date employ radio technology to determine the location of the pen. The HP uses a touch-sensitive screen, which means you are not limited to using its special pen. But there are a couple of significant drawbacks. The actual touch screen is a layer of plastic over the display that reduces the sharpness of images. And touch is much slower and less accurate than the radio technology, so handwriting recognition suffers.

My favorite device is actually the plain-Jane Lenovo ThinkPad X60 Tablet (from \$1,823). This modified version of the workhorse ThinkPad X60 notebook lacks glitzy features and seems a bit old-fashioned with a squarish 12.1-in. display. But it is simply a pleasure to use, in tablet or clamshell mode. Some battery configurations give it 10 hours of running time. And at purchase, you can choose among display options, including touch screen and a more rugged one for outdoor use. Like Toshiba, it can be equipped to work with Verizon Wireless' high-speed mobile data service.

I find that I mostly use these convertible notebooks with the keyboard, but there are chores—photo editing, to pick one—that are a lot easier to do with a pen. Now that pen support is built into Windows, I suspect a lot of laptops will become more useful by gaining Tablet features. ■

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Edgy Days at the Top of Time Inc.

I am only here for another three years,” says Time Inc. Chairman-CEO Ann Moore. “I am going to be known for transforming Time Inc. For diversifying Time Inc. And I am going to be the person who leads the transformation, to make sure we are around for another 80 years.” ¶ When Moore talks about diversifying, she’s referring to the stellar growth at

women’s titles she oversaw during the 1990s at a company built on men’s magazines. When Moore says “transformation,” she means Time Inc.’s recent—some will say too recent—lunge towards the digital world. While Moore thinks about her legacy, others ponder something different: How much of Time Inc.’s current woes stem from an unforgiving business cycle and how much from Moore’s management? Since 2002, when the fiercely talented Moore started running the world’s largest magazine company, the threat posed by online media has become brutally clear to even the most hard-core print supremacist. Parent Time Warner underwent a highly public siege from investor Carl Icahn. Time Inc. itself atypically began missing budgeted numbers and, also atypically, sold 18 magazines. (Industry wisdom long held that Time Inc. was a buyer, never a seller.) Revenues dropped in 2006. And the unit underwent a long, wrenching series of layoffs that ended only in January.



TIME INC. FACES DEMANDS to hit parent-mandated growth numbers when, company executives concede, funds for ambitious launches are scanty and when mature magazines such as *Time* are eroding and *People* is forced to beat record years. Meanwhile, the meteoric growth of recent smashes *Real Simple* and *InStyle* has slowed. Moore says she can eke out sufficient growth without launching new titles. Hence, her tricky bet that revamped digital properties such as *People.com*, which not surprisingly commands a sizable audience, will carry the day. But *People.com* essentially had an “on” switch flipped last July. It was previously locked up in a years-long agreement with corporate sibling AOL. Moore negotiated that deal. She still defends it when asked if *People.com*’s late entry has retarded its digital progress.

Moore made her bones in the Nineties by coaxing additional hundreds of millions in profit out of a *People* franchise many thought had peaked. She is the first woman to run what was long an extraordinarily old-boy company.

She says her rise in the Eighties was “fun,” but it couldn’t have been easy. One sometimes senses the residue of old-boy resentments in private comments by other executives. She

had the misfortune to follow Don Logan, likely his generation’s most respected magazine executive, just before the unit hit new headwinds. (Good timing, evidently, is among Logan’s many gifts.) Logan presided over layoffs after Time Warner’s disastrous merger with AOL, but it’s telling that, unlike today, internal grumbles back then concerned the visigoths behind a cockeyed deal and never the guy at the top. Even Moore fans wince at how she handled layoffs, wondering why there were multiple rounds—and one just before Christmas.

(Moore says Time Inc.’s massive size meant a thorough review, including input from consultants McKinsey & Co., and had to be completed in stages.)

Today a straitened Time Inc. plows ahead.

MOORE In a tough climate, is she helping or hindering?

On the drawing board: a potential health Web portal, including content from other Time Warner properties, to compete with the likes of WebMD. The company is nearing a digital deal, which may be done by the time you read this. Some insiders say the intense pressure on Moore has moderated, but the strain shows. At last October’s Magazine Publishers of America conference, her high-strung demeanor and bizarre gestures on stage—she alternated between pounding and stroking the furniture—was much remarked upon. Days later, though, she turned in a bravura performance presenting her digital strategy at a board meeting. At a January conference where she promoted Time’s digital initiatives, she conceded “it will be hard work to balance print loss with online gains.” Trembling on that knife edge is the fate of her career. ■

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BY JAMES C. COOPER

Bernanke's New Burden: Tight Labor Markets

Rate hikes and political tension could be in store for the second half

U.S. ECONOMY

The Federal Reserve's policy meeting on Jan. 30-31 was more notable for marking the Fed's first anniversary under Chairman Ben S. Bernanke than for the widely expected decision to keep the target interest rate at 5.25%. After Bernanke's shaky start in the big oval table's hot seat, questions about his resolve in fighting

inflation, communication with the markets, and his discretion about policy comments around reporters have become moot. Bernanke has won the respect of both Wall Street and Washington, and Fed policy has received high marks from both camps, especially on the timing of the decision to stop raising rates back in August.

Now comes Chapter Two. The early pages look boring, but hang on. With the economy apparently emerging from its slowdown and inflation edging lower, Fed policy will very likely remain unchanged for at least the next several months. The calm should allow policymakers to concentrate on their discussions of how best to communicate their policy ideas to the markets, with a special focus on setting a numerical target for inflation.

Deeper into 2007, though, Fed policy could turn into a real page-turner. In 2006 the Fed attempted to find a level for interest rates that would be high enough to keep inflation under control yet avoid an outright collapse in housing that could send the economy spiraling into a recession. Mission accomplished: From all recent signs, home demand is now firming. Sales of new homes in December increased for the fourth time in the past five months, and the stock of unsold homes is shrinking.

This means, by the middle of the year, housing may not need any more special consideration from the Fed. If the rest of the economy continues to be as strong as it is now, the absence of the drag from housing could cause growth to heat up several degrees too high for the Fed's comfort. That would put the possibility of rate hikes back on the table, a prospect Wall Street is clearly not prepared for and one that would bring the Fed considerable political scrutiny from the new Democratic Congress.

THE LABOR MARKETS are fast becoming the Fed's central focus, and they are at the heart of both the economic and the political stories. Last year the Fed forecasted the economy would slow enough to allow inflation to ebb. It got that part right. Indeed, the Fed delivered a much more upbeat appraisal of both economic growth and inflation in its statement following the Jan. 31 rate decision. However, last year the policymakers also expected slower growth to unwind

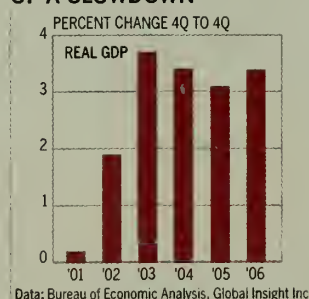
some of the tightness in the labor markets and foster confidence that rising labor costs would not reignite inflation. That part, they missed.

Last July the Fed projected the unemployment rate, which began the year at 4.7%, would end the year in the 4.75% to 5% range. However, the rate fell further, hitting 4.5% in December, a sign that job markets were getting tighter not looser. That's why the Fed's Jan. 31 statement highlighted "the high level of resource utilization" as a potential threat to future inflation. It's also why the policymakers continue to lean toward the need to raise rates, not lower them.

SURPRISINGLY STRONG economic growth in the fourth quarter means the economy has picked up to a pace that, if sustained, will push the jobless rate even

lower. The Bureau of Economic Analysis reported on Jan. 31 that real gross domestic product increased at an annualized rate of 3.5% during the fourth quarter, and the breakdown of the report suggests continued strength (chart). Led by a solid 4.4% advance in consumer spending, demand in all sectors

NOT MUCH OF A SLOWDOWN



increased at a healthy 4.2% rate, despite the biggest quarterly decline in outlays for new housing since the 1990-91 recession. Housing will almost certainly be a drag on growth in the first quarter as well, but not nearly as large as in the fourth quarter.

The other big minus last quarter came from inventories, but that is set to turn around, too. Inventory growth slowed sharply, subtracting 0.7 percentage points from real GDP, but the slowdown means businesses have taken a big step toward reducing their bloated stockpiles, especially unsold autos. The reduction will help clear the way for a reacceleration in production in coming months,

a speedup that has already been seen in the faster pace of December manufacturing output.

Consumers are leading the growth pickup, because they are feeding off the strength in the labor markets. That was clear from the Conference Board's January index of consumer confidence, which rose to the highest level in nearly five years. Fewer households characterized jobs as "hard to get," while the proportion saying jobs were "plentiful" was the largest since 2001. Those jobs are generating big gains in incomes.

The Fed's potential problem in 2007 lies on the flip side of strong labor income: higher labor costs for businesses. The Fed's concern is that the economy will be strong enough to allow companies to pass their rising costs on to consumers in the form of higher prices. The minutes from the Fed's Dec. 12 meeting made a special note of rising labor costs as an inflation risk.

The Labor Dept.'s fourth-quarter employment cost index, an accounting of hourly wages and benefits, shows the upward drift. The ECI for private-sector workers, which economists believe is the most accurate gauge of hourly pay and benefits, rose 3.1% from a year ago, and the pace edged up though the year (chart). Benefits slowed, but wage growth picked up notably, a result of tighter job markets that may only get tighter.

THE FED WILL come under greater political scrutiny in Bernanke's second year, especially if the policymakers feel compelled to lift interest rates due to tight labor markets. Bernanke is sure to face questions on this subject when he makes the Fed's semi-annual report on monetary policy to Congress on Feb. 14 and 15, speaking

before the Senate Banking and House Financial Service Committees. The new chairman of Financial Services, Representative Barney Frank (D-Mass.), has been outspoken recently about the Fed's commitment to jobs and wages, and he opposes Bernanke's long-held desire to establish a numerical target for inflation.

THE FED IS EYEING LABOR COSTS



The February testimony may give Bernanke his first opportunity to defend his inflation-targeting ideas. The Fed continues to discuss the strategy in the context of how to communicate its policy more openly, but progress has been slow. Frank is against the play out of fear that setting a target for inflation

alone would dilute the central bank's congressionally mandated responsibility "to promote effectively the goal of maximum employment, stable prices, and moderate long-term interest rates." Bernanke will have his hands full trying to explain to Frank and others why focusing only on inflation does not demote the importance of employment within the Fed's multipronged mandate.

One thing is certain: If the Fed has to lift rates later this year, it will raise the ire of both Washington and Wall Street, except that the markets won't voice their displeasure in words. Their anger will be felt in lower prices for stocks and bonds. ■

MULTINATIONALS

Expanding Abroad—and Growing at Home

FOREIGN DIRECT investment by U.S. businesses and investors in 2006 is on track to be the second highest on record. Meanwhile, manufacturing payrolls fell for a ninth straight year. Based on those trends, it would be easy to conclude that Corporate America is engaging in widespread outsourcing with potentially detrimental effects on the U.S. economy. But more detailed figures from America's big companies paint a different picture: About 88% of sales among foreign affiliates of U.S. multinationals are made in the local country and other places outside the U.S.

Those are the latest numbers from

a Bureau of Economic Analysis annual survey of U.S. multinational operations for 2004. The total is up slightly from the 1994 results. Plus, domestic operations of U.S. multinationals "have maintained a steady share of the economy," says Daniel J. Meckstroth, chief economist at the Manufacturers Alliance/MAPI, a nonprofit policy research organization.

In 2004 output of nonfinancial U.S. multinationals accounted for 22.7% of nonfinancial gross domestic product, virtually unchanged from 1994. And while manufacturing's share of the U.S. workforce and economic output have fallen, the

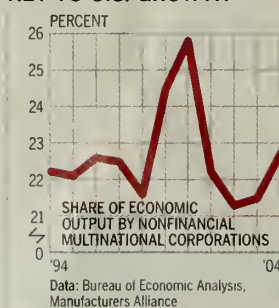
government data show the rate of decline among multinational and non-multinationals is very close.

The results do not imply a large-scale movement of operations abroad by U.S. business. Rather, companies want to expand their global presence, and this larger scale of operations requires more workers at home to manage the business, says Meckstroth. That means greater demand for high-skill jobs in areas such as professional and business services, where hiring is strong.

With global growth expected to hold up quite well this year, U.S. multinationals are likely to keep up with their foreign expansion plans and invest heavily abroad. Expanding into faster-growing markets should bolster both profits for multinational and hiring at home—not a bad combination. ■

—By James Mehring in New York

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The Business Week

News you need to know

EDITED BY HARRY MAURER



Icahn Calling It's likely a CEO's worst nightmare: **Carl Icahn** on Line 1. And **Motorola CEO Edward Zander** could be getting that call soon. On Jan. 30 the billionaire investor said he has taken a 1.39% stake in the cell-phone maker and wants a board seat. Proxy battles have become Icahn's weapon of choice: In 2005 he forced himself and two allies onto the **Blockbuster** board, and last year he was named chairman of **ImClone Systems** after a proxy fight.

A notorious bottom-fisher, Icahn (photo, above) no doubt sees value in Motorola, whose stock has faded 30% in the past year and picked up 6% after Icahn filed his stock position with the SEC. What he might do on the inside at Motorola is unclear, especially since it's already on a cost-cutting tear. But Motorola, which says it will consider Icahn's request before its still-unscheduled annual meeting, had best take him seriously. When Icahn starts dialing, the calls usually get more threatening.

See "All this and Icahn, too," page 34,

ONLINE "Icahn sets his sights on Motorola," www.businessweek.com/go/tbw

Drug Merger Talk Look out, **Pfizer**—the French may covet your crown. Is France's **Sanofi-Aventis** mulling a bid for beleaguered U.S. drugmaker **Bristol-Myers Squibb** to create the world's largest pharmaceutical outfit, with \$56 billion in sales? The two have long been seen as natural partners thanks to their marketing alliance for blockbuster blood-thinning drug **Plavix**. Rumors of a deal in French newsletter

La Lettre de l'Expansion on Jan. 29 fueled furious trading both stocks, with Bristol stock rising 9.8% by Jan. 31. The companies aren't commenting.

ONLINE See "Is Sanofi-Aventis after Bristol-Myers" www.businessweek.com/go/tbw

Dell Takes Over "There is no better person in the world to run Dell at this time than the man who created" the company, said **Samuel Nunn Jr.**, lead director of Dell's board in a statement on Jan. 31. Founder and **Chairman Michael Dell** is stepping in to run the troubled company again, replacing CEO **Kevin Rollins**, who resigned.

See "Is Dell too big for Michael Dell?" page 10

Reining in Regulators With a stroke of his pen, **President George W. Bush** tightened control over most federal agencies. *The New York Times* reported on Jan. 30 that a Jan. 18 White House directive requires regulators to clear policy and industry guidance with a new Presidential gatekeeper. Independent agencies like the **Fed** and **SEC** aren't covered by the order. In the meantime, the Senate tried to raise the \$5.15 hourly minimum wage by \$2.10 an hour. But it couldn't do so without throwing in \$8 billion in tax breaks for the small businesses footing the increase. The tax package complicates negotiations with the House, where Democrats are throwing a fit over the tax cuts.

A Deal Shot Down **US Airways'** hostile bid for **Delta Airlines** has been grounded. On Jan. 31 the Tempe (Ariz.) carrier announced it was abandoning its \$9.75 billion offer shortly after Delta's creditors' committee said it would instead back the plan developed by management to exit bankruptcy as an independent. But don't expect Delta to fly solo for too long. Analysts still believe that once it leaves Chapter 11 later this year, it could pursue a wingman it prefers, most likely **Northwest Airlines**.

Go-Go GDP The U.S. economy trounced expectations by about half a percent, growing at a 3.5% annual rate in the fourth quarter. Buoyant consumer spending and a narrower trade gap offset another big drop in homebuilding. The surprise on trade: Exports jumped at a 10% annual rate while imports slipped 3%. The **Commerce Dept.'s** Jan. 1 advance report, which is subject to revision, terminated a talk of a rate cut by the **Fed**. Later in the day, Fed rate-setters stood pat at 5.25%.

Citigroup Fallout The Jan. 22 ousting of **Citigroup** wealth management chief **Todd Thomson** by CEO **Chuck Prince** was followed by a *Wall Street Journal* report that Thomson had been let go for spending lavishly and for putting too much promotional money behind programs and events involving **CNBC** anchor and *BusinessWeek* columnist **Maria Bartiromo**. That led to a round of stories and columns raising ethical questions about Bartiromo's behavior because she appeared at events sponsored by Citigroup, a frequent CNBC advertiser, and flew on a company plane. Both Thomson

id Bartiromo declined to comment. CNBC, calling Bartiromo "one of the most prolific and well-respected financial journalists in the industry," said she made 46 company-approved appearances in 2006 on behalf of the business news network, three at Citigroup-sponsored events. CNBC said it approved the flights and would reimburse Citigroup commercial rates. It added that Bartiromo was not compensated for her appearances. Bartiromo's *BusinessWeek* column, *Face Time*, appears on page 104.

New Dawn for Vista It took more than five years and an investment of \$6 billion, but **Microsoft's Windows Vista** operating system finally debuted for consumers on Jan. 30. **Chief Executive Steven Ballmer** predicts that initial sales will double those of the previous update, **Windows XP**, in 2001, and PC makers expect zippier sales. But in the consumer technology sphere, Windows and Microsoft have been edged out on the excitement meter by the likes of **MySpace.com**, **YouTube**, and **Apple's iPhone**.

See "Bill takes a bite out of Apple," page 38,
ONLINE "Getting the skinny on Vista security,"
www.businessweek.com/go/tbw

Detroit: Red Ink City Ford is an historic icon in American culture and business, but on Jan. 25 the company made history of another sort by posting its biggest annual loss ever: \$12.7 billion in 2006. Much of that went to buyouts for some 38,000 employees and to shutter plants to cope with falling market share. Meantime, **Toyota** is poised to pass Ford as No. 2 in U.S. sales this year.

See "Putting Ford in the rearview mirror," page 44,
ONLINE "The record year Ford hopes to shake off,"
www.businessweek.com/go/tbw

Spin-Off of the Week

You're on your own now, kid. After housing **Kraft Foods** for nearly 19 years, **Altria** announced on Jan. 31 that it would spin off its 89% stake in the packaged-food giant to shareholders on Mar. 30. Altria looks like it'll do just fine as an empty-nester. The company will focus on the **Philip Morris** cigarette business—its **Marlboro** is No. 1 worldwide—and benefit from its 29% interest in another former subsidiary, brewer **SABMiller**. But it may take time for Kraft to find its way. The company has plenty of potential: A half-dozen of its brands boast sales of \$1 billion or more. But many seem tired. Earnings before one-time items inched up 3% in 2006, to \$3.2 billion, on a less than 1% rise in revenue, to \$34.4 billion. **CEO Irene Rosenfeld**, brought in from **PepsiCo's Frito-Lay** division last June, pledges a turnaround—but warns it won't happen overnight.

See "It just got hotter in the kitchen," page 36

ONLINE "Kraft: Time to sink or swim"
www.businessweek.com/go/tbw



KRAFT FARE ON THE SHELF

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(CD)

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for inadequate
broadband coverage.



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BroadbandConnect.**

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huge files and attachments
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EXECUTIVE CHURN

HELLO, YOU MUST BE GOING

It's not just new CEOs who have to hit the ground running. There are no more honeymoons for top-level managers.

BY NANETTE BYRNES AND DAVID KILEY

WHEN CATHERINE West arrived at J.C. Penney Co.'s Plano (Tex.) offices in June as the new chief operating officer, she brought a gold-plated record. A veteran of credit-card giant Capital One Financial Corp., West had most recently run the company's \$47 billion U.S. business. Penney CEO Myron E. Ullman called her a "world-class" executive. He was so confident she had what it would take to succeed that he gave her a contract guaranteeing a \$10 million payment when she left the retailer, even in the remote event that she took off in less than a year.

That's just what happened. By Dec. 28, Ullman felt no holiday goodwill toward West. She was terminated "due to her failure to satisfy performance objectives," primarily "gaining an understanding of the company's operations," Penney reported to the Securities & Exchange Commission. In an e-mail message, West termed her months in Plano "an extraordinary developmental experience."

Perhaps, but her tenure was no success. Nor was it an isolated event. It caps

off a steady march of other highfliers who have not lasted even a year. Some, like West, came from outside and fell short. Others have spent decades reaching for the gold ring, only to let go after it was in their grasp. At Wal-Mart Stores Inc., two marketing managers and the head of global procurement left, all in under 12 months. Home Depot Inc. lost its head of marketing and merchandising, Tom Taylor, in similarly short order. Gap Inc. said good-bye to veteran Liz Claiborne Inc. manager Denise Johnston after only nine months in her role heading up Gap Adult. Software maker Adobe Systems Inc. and retailer Sears Holdings Corp. both lost chief financial officers within six months. And Ford Motor Co. continued to crank through executives, among them Chief Operations Officer Anne Stevens, who lasted 11 months in that role.

Once thought most likely to succeed, this is the unhappy class of 2006, the year's fastest failures. Many did not even make it to their first annual review. It isn't easy for a star performer to flame

out so quickly, but it's getting easier. The brutal reality is that executives have less time than ever to prove their worth. Tough global competition, more diligent regulators, increasingly engaged boards of directors, and demanding investors have combined to create an environment in which a new hire has to show results almost from Day One. The pressure is especially acute for outside recruits. According to RHR International, a Wood Dale (Ill.) firm that specializes in developing top managers, 40% to 60% of high-level corporate executives brought in from outside a company will fail within two years. Those who do fail most often derail quickly, sometime between seven and nine months in the job.

"You have to perform or perish," says John A. Challenger, CEO of Chicago outplacement firm Challenger, Gray & Christman Inc. "If you don't produce immediate results, you just don't have much room to move." Last year there were 28,058 executive turnovers, including board members and executives from CEO down to vice-president, a 68% increase over 2005, according to Liberum Research's analysis of North American public companies. Of those, 44% of the positions were filled from outside the company.

WILD RIDE For an inside account of Julie Roehm's rough year at Wal-Mart, please see page 70.



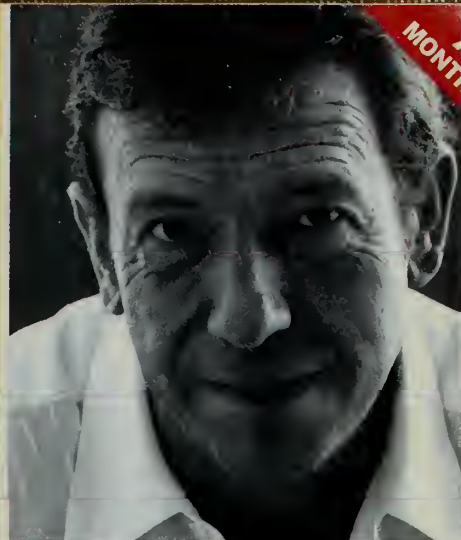
11
MONTHS

STEVENS,
OTOR
AMERICAS



13
MONTHS

CHARLES CHAMPION,
AIRBUS
CHIEF OPERATING OFFICER



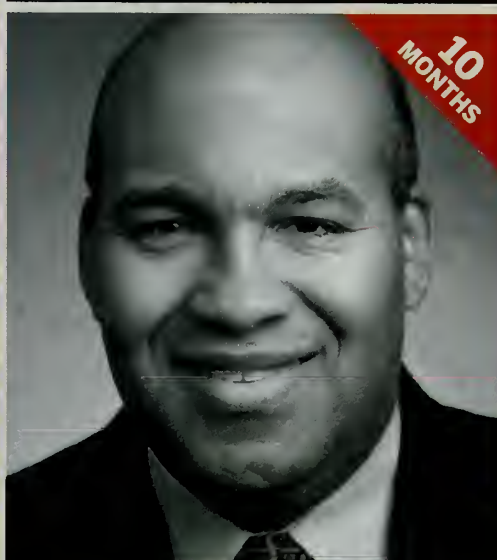
1
MONTH

CHRIS JAKES,
YOUNG & RUBICAM
CEO OF Y&R NORTH AMERICA



11
MONTHS

RD K. WILLARD,
L-MYERS SQUIBB
AL COUNSEL



10
MONTHS

LAWRENCE V. JACKSON,
WAL-MART
CEO OF GLOBAL PROCUREMENT



5
MONTHS

CRAIG MONAGHAN,
SEARS
CFO



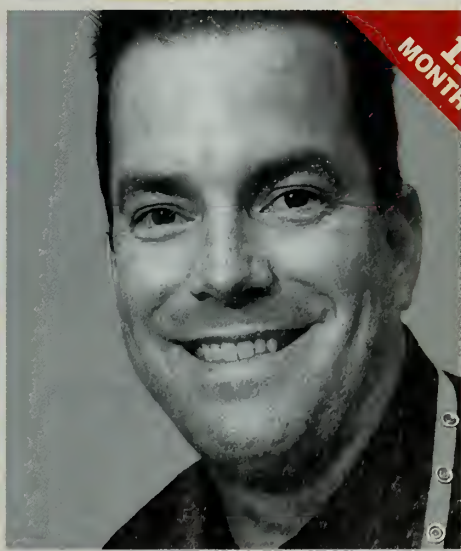
7
MONTHS

ERINE WEST,
NNEY



42
DAYS

XIE WEN,
YAHOO! CHINA
PRESIDENT



1
MONTH

TOM TAYLOR,
HOME DEPOT
MARKETING & MERCHANDISING CHIEF

When a company ejects a high-profile hire in under a year, the problem is usually not one of ability but of style. The person clashes with the CEO, inspires resentment in co-workers, or pushes for too much change too quickly. Jeff Durocher, RHR's vice-president of market development, says his firm's research has found most fast failures come when managers haven't established a network of allies and confidants or adapted to the company's culture but instead see themselves as special and unique. "We call it tissue rejection," says Durocher. "They get no support from the people around them."

However humiliating failure is for the executive, it is also costly and embarrassing for the company. People recruited from the outside usually go through a series of extensive interviews with peers, the board, and the CEO. The company often has to pay large fees to headhunters and purchase expensive furniture to spruce up the new star's office. Replacing a failed C-suite executive can easily cost another \$1 million to \$3 million.

Even so, ending a bad match sooner is better than doing it later. "It takes some maturity to recognize a mistake and correct it," says David P. Sievers, consumer products and retail practice leader for Archstone Consulting. Sometimes it's the employee who is the first to confront the problem. Joseph V. Tripodi, now chief marketing officer of Allstate Insurance, found himself unhappy almost immediately after taking a new marketing job at Bank of America Corp. "I knew within a month it was not the right thing for me," says Tripodi. "It's a difficult conversation to have, but all parties are best served by the person who realizes the fit isn't right."

LOW TOLERANCE FOR ERRORS

THE NEW HIGH-PRESSURE climate reaches to every member of a company's top management. At large companies, chief financial officers are turning over at a rate of 22% a year, according to Russell Reynolds Associates, because CFOs

are under pressure in the regime of Sarbanes-Oxley, but also because they are the face of the company to Wall Street. "The tolerance for mistakes and surprises has really gone down," says Russell Reynolds' Gordon Grand. The stock options backdating scandal unfolding across the country has taken its fair share of CFOs, but also shown the vulnerability of general counsels, several of whom have been dismissed over the issue.

But if there's one job that is most firmly in the danger zone at present, it's not the general counsel, chief operating officer, or even the chief financial officer. It's the chief of marketing, a spot with a dangerous combination of lofty goals and quickly measured returns. Sales are monitored weekly, ad campaigns built quickly. So while the typical CEO today has a five-year tenure, search firm Spen-

About half of executives brought in from outside will fail within two years

was not returned.

McLennan acknowledges that "losing a key executive is disruptive." While predicting how an international move will turn out is hard, he argues that it's worth taking the chance for a promising tale. "In today's world where our jobs can be so uncompromising and stress-filled with BlackBerrys going off 24/7, you have to make some concessions for people you think are valuable." ■

cer Stuart has found chief marketing officer only 23 months in the job.

Marketing problems often come down to an inability to create allies quickly in a new company. Ser Vice-President of Marketing Communications J. Roehm, who had a recent fast exit from Wal-Mart, came in from a very different world—cars—to jazz up the retailer's image. After only 10 months, she was out and suing her former employer for wrongful dismissal.

One problem, says state's Tripodi, is that many new marketing executives come in with a mandate to shake up a company. "If you're wearing on your chest a bull's-eye that says 'I'm a big-change agent who's going to fix the company,' you're going to get shot," says Tripodi.

"Left for personal reasons" often is code for performance failure, but sometimes it's true. The rising globalization of business, which has created opportunities to move into the worldwide talent pool, seems to be making it more so. Young & Rubicam Brands CEO Hammett McLennan found that when he recruited Ch. Jaques to run his North American business, Jaques had done well in Asia for Y&R but had never lived in New York when he took the job. He and his family couldn't adjust to the new environment. "They were very unhappy about the lifestyle change," says McLennan. A call to Jaques



EXECUTIVE SHUFFLE

IS DELL TOO BIG FOR MICHAEL DELL?

He's back in charge—and he may have the toughest job in the computer business

BY LOUISE LEE
AND PETER BURROWS

WELCOME BACK, Michael. Don't get too comfortable.

By returning to the top job at Dell Inc., replacing departing Chief Executive Kevin Rollins, founder Michael Dell takes on perhaps the toughest job in the computer industry. Since mid-2005 the PC maker has battled problems with customer service, quality, and the effectiveness of its direct-sales model. Lately, rivals Hewlett-Packard Co. and Apple Inc. have been gaining in sales and market share. On Jan. 31, the day Rollins' departure was announced, the Round Rock (Tex.) company disclosed that its fourth-quarter earnings and sales would fall short of analyst estimates. It's also under scrutiny by the Securities & Exchange Commission and a U.S. attorney for accounting irregularities.

As recently as last November, Dell insisted to *BusinessWeek* that Rollins' job was safe. Now, in an interview, he insists the decision to push Rollins out started with him. "I recommended to our board that I become the CEO," Dell says. For years, Dell and Rollins were held up as a prime example of the company's "two-in-a-box" management structure, in which two leaders worked together in lockstep. When Rollins was president, Michael Dell was

CEO; when Rollins was promoted to CEO in 2004, Michael remained chairman. But financial performance has been deteriorating for a while now, and Michael Dell apparently ran out of patience in light of the latest disappointment. "People are looking forward to a change," said an analyst at one of Dell's largest institutional shareholders. Indeed, the company's share price jumped 3.6% in the couple of hours after the shift was announced.



But does Michael Dell have what it takes to turn the company around? It's been years since he shouldered day-to-day operational responsibility on his own. Since the early 1990s, Dell has always had a strong No. 2; back then, the company had less than \$3 billion in yearly sales. Today it is a \$60 billion

company. But Dell says he has a clear plan. He believes the company's supply chain and manufacturing can be improved. "I think you're going to see a more streamlined organization, with a much clearer strategy."

But none of the paths to improve performance will be easy. Dell doesn't have the innovation DNA of an Apple or even an HP, should it want to overhaul its utilitarian products and services. Any effort to crank up R&D would crimp margins. Trying to win over more consumers, the fastest-growing part of the market, may well require a move away from its direct-sales model into retail. That could prove costly as well. Dell himself says he doesn't anticipate leaving the direct-sales model behind: "It's a significant strength of the company." Nor does a big acquisition seem to be an option, given that Dell has never done one in the past.

SLOTS TO FILL

BUT STANDING IN place also looks hazardous, since Dell may now be slipping in its core corporate business, too. According to a Jan. 30 study done by Goldman, Sachs & Co., Dell is losing share in business spending for PCs. (Hewlett-Packard is also losing share of spending, while Lenovo and Apple are gaining.) "Dell's troubles seem to be bleeding into its corporate business, which, up until now, had been a stronghold," the report said. Dell has also lost the top spot in the worldwide PC market-share rankings. In the fourth quarter, Hewlett-Packard's worldwide market share grew to 18.1%, while Dell's share dropped to 14.7%, according to market researcher IDC.

Dell also has several slots to fill in the executive suite; Rollins is only the latest departure among key managers. But for the first time in years, the tough choices will be solely in the lap of the man who started the company in his University of Texas dorm room back in 1984. "I'm not hiring a COO or a CEO," Dell says. "I'm going to be the CEO for the next several years." He adds: "We're going to fix this business." ■

UNCOUPLED

Once, Dell and Rollins were "two-in-a-box"

SLUMPS

ALL THIS AND ICAHN, TOO

As Ed Zander battles falling earnings, Motorola attracts a demanding investor

BY ROGER O. CROCKETT

FOR ALMOST TWO YEARS running, Edward J. Zander looked like a genius. The Motorola Inc. chief executive executed flawlessly on his strategy of cranking out “wow” products like the RAZR phone and delivering them via an ever-more-efficient supply chain. Then Zander ran head-on into a cell-phone price war. Suddenly the CEO, known for his morale-boosting talks, had a serious problem. Earnings plummeted by nearly half in the fourth quarter of 2006 as profit margins sank. Motorola’s share price has fallen 24% since last October.

Can it get worse? Sure—Zander could have a pushy billionaire investor on his case. Here comes Carl C. Icahn, who Motorola announced on Jan. 30 has amassed 1.4% of Motorola’s shares and wants a seat on its board. And Icahn isn’t mincing words. He wants Motorola to spend all of its \$11.2 billion stockpile to repurchase shares. “It’s ludicrous that they have all this cash and don’t do a buy back,” he says. “That cash could be better managed by shareholders than by the company.” Motorola says it is reviewing Icahn’s request.

A big buyback would make many investors happy. But Icahn’s arrival raises a bigger question than just one of cash management: Is Zander’s strategy still workable? Many recent Motorola efforts to replace the RAZR with a hot new phone have faltered. The Rokr, a music phone that launched with Apple’s iTunes a couple of years ago, failed to bowl over consumers. Nor did the PEBL, a round-

ish flip phone, or the KRZR, a skinnier version of the RAZR from last fall. “They’ve had four to five duds in a row,” says Citigroup analyst Daryl Armstrong. “And people are not willing to give them the benefit of the doubt.”

Execution has been Zander’s biggest problem. Motorola lags its chief rival, Nokia Corp., in the kind of production efficiency that leads to high margins. One former executive says Motorola is trying to be a first-rate consumer-electronics company while also outsourcing its manufacturing to third parties. That makes it difficult to manage

quality because products go through multiple hands before they get to the consumer. Nokia, on the other hand, has greater control over its manufacturing. On a scale from 1 to 10, Armstrong gives Nokia a 10 for its manufacturing efficiency and Motorola a 4 or 5. That’s a big reason why Motorola has overall gross profit margins of 25% vs. Nokia’s 32%.

For now, Zander is concentrating on cutting costs. In a Jan. 19 call with analysts, he said he’s cutting 3,500 jobs. Motorola also has to get a better handle on forecasting how many phones it needs to build. Parts suppliers say that working with the company is more difficult than with other manufacturers because of

volatility in product flow. One day Motorola might indicate that it needs parts for millions of units; the next day it may cancel that particular device, according to suppliers. The uncertainty leads to a greater chance of defective parts and missed deadlines in product launch, analysts say.

Icahn only increases the pressure to fix those problems. When he doesn’t get his way, he has been known to threaten

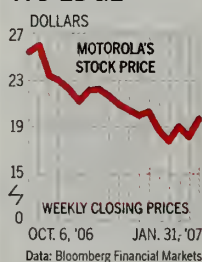
a proxy fight, as happened at Time Warner Inc., and push for a breakup. Icahn says that isn’t his plan for now, but added: “We may focus on stuff like that on another date.”

In the event of a breakup, Zander may be forced to consider jettisoning its networks business. That unit specializes in wireless broadband gear for emerging technologies such as WiMAX, and Zander considers it a key to future growth. But Motorola has left itself vulnerable by focusing largely on radio frequency technology, which several companies prefer, while rivals such as Alcatel-Lucent and Nokia have built a capability in more proprietary switching technologies that are in demand by wireless carriers.

Still, many investors would cringe if Motorola had to get rid of a business that is so tightly integrated with its bread-and-butter mobile-device business, says Lawrence Harris, analyst with Oppenheimer & Co. A major reason for Icahn to move cautiously. “He brought up a very reasonable question of strategy,” says Henry Asher, president of Northstar Group Inc. in Manhattan, which owns a small stake in Motorola. “It began a dialogue.” ■

—With Olga Kharif in Portland, Ore.

RAZR LOSES ITS EDGE



Data: Bloomberg Financial Markets

BAD CALLS?

Phone launches haven't fared well lately under Zander



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EXECUTIVE SUITE

IT JUST GOT HOTTER IN KRAFT'S KITCHEN

Pressure on the CEO builds as Altria unloads its stock in the food giant

BY MICHAEL ARNDT

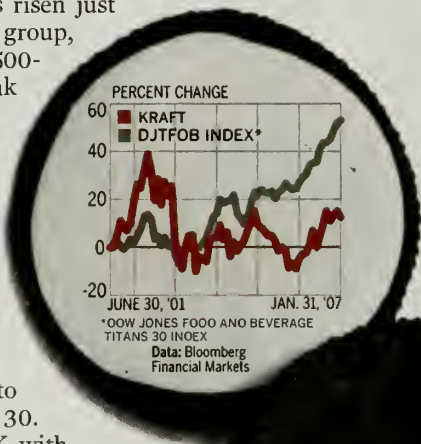
AS KRAFT FOODS INC. used to remind consumers, America spells cheese k-r-a-f-t. Lately, those letters have been spelling something else: frustration. Since Altria Group Inc. spun off a minority interest in Kraft in mid-2001, the stock price of the packaged-food giant has risen just 12.6%, lagging its peer group, the Standard & Poor's 500-stock index, and even bank certificates of deposit.

Now, the pressure on Kraft Chief Executive Irene B. Rosenfeld to provide shareholders with a tastier investment is becoming more intense. On Jan. 31, Altria said it will distribute its remaining 88.6% stake in Kraft to shareholders on Mar. 30. Altria may have been O.K. with an underachiever; if nothing else, Kraft's steadiness helped balance the uncertainties of Altria's cigarette business. But outside stockholders generally want to see quick results. Timothy G. Ewing, co-manager of a large-cap value fund at Mesirow Financial Holdings Inc. in Chicago, sold all of its 200,000 Kraft shares last fall. "We just didn't see a lot of upside in it," he says.

Rosenfeld concedes that Kraft needs to slip into a higher gear. "It's time to grow. Our investors have told us that, and I would agree with them," she says. "But this is not *Extreme Makeover: Home Edition* that'll get fixed in 60 minutes. We've got some fundamental work to do."

In the short term, in fact, Kraft's results may suffer. Analysts say Rosenfeld, 53, who was brought in last June from PepsiCo Inc., where she was chief executive of its Frito-Lay division, will have to hike outlays on marketing, R&D, and information technology to make up for inadequate spending in the past. Kraft also will have to pay 4.9% more for raw ingredients in 2007,

NOT WORTH THE CALORIES?
Kraft's stock has underperformed its peer group by a wide margin



after benefiting from a small cost decline in 2006, figures analyst Edgar Roesch of Banc of America Securities. In addition, the overnight release of nearly 1.5 billion Kraft shares is expected to swamp demand.

Higher expenses in 2007 should keep returns close to flat. David Nelson, an



ROSENFELD Intern. growth has been s

analyst with Cr Suisse, predicts K will net \$3.1 billion or \$1.90 a share in 2007 on sales of \$35.1 billion. R

son's target price for Kraft stock over next 12 months: \$31 a share, the same price it opened at in its initial public offering 5½ years ago.

Kraft has a lot going for it, of course. The Northfield (Ill.) company is the nation's biggest maker of packaged food and second worldwide only to Nestlé of Switzerland. Look through the kitchen of 200 U.S. households and you'll find a Kraft product in all but one of them. Its brands include Oscar Mayer, Planters and Nabisco. A half-dozen boast sales of more than \$1 billion a year, while the top \$100 million. And the company has also had some new successes. Sales of South Beach Diet line of products, introduced in early 2005, rose to \$350 million last year, estimates analyst Roesch. California Pizza Kitchen frozen pizzas are selling well, too.

GETTING STALE

PROBLEM IS, OTHER old brands like Velveeta, Maxwell House, and Jell-O are sinking. Like its rivals, Kraft has tended product lines to get the most from its blockbusters. But the strategy may have played out. The company already markets 14 varieties of Oreo cookies, for instance. How much pop, analysts ask, could 15th possibly provide? Rosenfeld agrees. "We need to rebuild our pipeline."

Under Altria, management used acquisitions, such as the \$18.9 billion takeover of Nabisco in 2000, to overcome slow internal growth. Rosenfeld says that now Kraft will be better able to use its stock, worth \$57.8 billion, to make more buys. She has started unloading noncore or underperforming brands; on Jan. 23, Kraft sold slow-growth Cream of Wheat brand for \$200 million. Others sales could include Oscar Mayer, Planters nuts, and Garden of Eatin' mustard, say analysts.

The initial logic behind the spin-off may have been to remove any potential cloud on Kraft from Altria's tobacco business, but now Altria seems to be doing its investors a favor by unloading the rest of Kraft. It may be some time though, before the breakup pays off for Kraft shareholders. ■

CAMPAIGN 2008

CRANKING UP THE MONEY MACHINE

Obama has been lining up Democratic fund-raisers, but Clinton has a lot more cash

JEAMON JAVERS

IN THE SCRAMBLE TO RAISE MILLIONS for the 2008 Presidential election, Jan. 24 was a pivotal day. Even as Senator John Kerry (D-Mass.) choked back tears during his announcement from the Senate floor that he would not seek his party's nomination, the cell phones and BlackBerry's of his fund-raisers across the country began buzzing.

Campaign aides and allies of Senators Hillary Clinton (D-N.Y.) and Barack Obama (D-Ill.) seized on the announcement and began dialing the 150 or so Kerry loyalists who had raised millions for his 2004 Presidential bid. "Everybody had their lists of Kerry people, and they were calling immediately," says John Roos, chief executive of Palo Alto (Calif.) law firm Wilson Sonsini Goodrich & Rosati, and a Kerry fund-raiser who now supports Obama.

Kerry's loss has primarily been Obama's gain. The newcomer has secured commitments from 27 of the 41 former Kerry backers who have

thus far declared allegiance to a new candidate, says a Kerry fund-raiser who is not aligned with either Clinton or Obama. Clinton has nabbed the other 14. None of the backers has yet joined any of the other Democratic hopefuls. "Senator Kerry told people that they ought to follow their own conscience," says Jay Dunn, national finance director for Kerry's political action committee.

Pinning down fund-raisers early is one sign of a campaign's viability. Obama's success has surprised some, given his relative inexperience and Clinton's deep ties to the Democratic Party.

Clinton's Senate campaign has \$14 million on hand, which the senator is free to transfer to her Presidential campaign; Obama has only about \$755,000. Clinton and Obama set up Presidential exploratory committees in January, but they don't have to disclose contributions until they formally enter the race.

A spokesman for Clinton says fund-raising has been strong at all levels. An Obama spokesman says the senator is grateful for the support he's received.

Although most fund-raisers stuck with Kerry until January, they had been court-

ed by Clinton and Obama for months. Mark Gorenberg, a venture capitalist at Hummer Winblad Venture Partners in San Francisco and Kerry's 2004 California fund-raising chair, met with both contenders in January and chose Obama. "I found him to be extremely charismatic, a natural leader in the same sort of way that John Kennedy was or Bill Clinton was," Gorenberg says. David Geffen and his DreamWorks partners Steven Spielberg and Jeffrey Katzenberg will hold a Beverly Hills soirée for Obama on Feb. 20. Billionaire financier George Soros has endorsed the Illinois senator.

Kerry's former New York finance director, Hassan Nemazee, was also wooed by both and says he's backing Clinton because "she's readiest to be President on Day One." Other Clinton supporters: Steven Rattner, managing principal of private equity firm Quadrangle Group, and Hollywood legend Elizabeth Taylor. Spielberg also will host a Clinton fund-raiser.

One key difference between Clinton and Obama is in their relationships with the financial set. Clinton has been on the national stage for 14 years. "In New York City, there are at least 100 people making fund-raising calls to their friends" on Clinton's behalf, says Alan J. Patricof, co-founder of private equity firm Apax Partners Inc. He chaired Clinton's senate campaign and supports her now.

Obama is the unproven investment. That didn't faze former Kerry fund-raiser Alan D. Solomont of Solomont Bailis Ventures, a Newton (Mass.) private equity firm. "I had to choose between IBM and a startup," he says. "But you know, look at Apple Computer." ■

The Race Is On

Barack Obama and Hillary Clinton are trying to reel in the Democratic Party's biggest campaign fund-raisers. Here's a sampling of wealthy business people backing each candidate.

FOR OBAMA

- **George Soros**
Founder, Soros Fund Management
- **David Geffen**
Co-founder, DreamWorks film studio
- **John Roos**
CEO, Wilson Sonsini law firm

FOR CLINTON

- **Alan Patricof**
Co-founder, Apax private equity firm
- **Hassan Nemazee**
CEO, Nemazee Capital
- **Steven Rattner**
Managing principal, Quadrangle Group



WHIRLWIND Gates flew from Davos to New York for the Vista and Office 2007 festivities

Q&A

BILL TAKES A BITE OUT OF APPLE

Microsoft's chairman on the Vista launch—and why he won't be buying an iPhone

Microsoft's new Windows Vista may be the last of a dying breed. It is almost certainly the last major software launch for Bill Gates. On Jan. 29, Microsoft Corp. staged event after event in New York City leading up to Vista's midnight release. Gates, Microsoft's chairman, had flown in the previous night from the World Economic Forum in Davos, Switzerland, to face a conversation-packed day that included Jon Stewart's attempts to pry loose his personal password on Comedy Central's The Daily Show.

In a wide-ranging interview with BusinessWeek Senior Writer Steve Hamm, Gates discussed more serious topics, such as the future of software and Apple's new iPhone. Edited excerpts of their conversation follow:

Recently, Apple Chief Executive Steve Jobs seems to be usurping your role as mind-share leader in the PC industry. What do you think about that?

Steve has always been a huge figure in the industry, and, in a sense, bigger than life, more visible than I am in some ways. I don't think anything has changed. He's still much more of an impresario than I

am. But Microsoft is better known. We have more impact. Remember, there are tons of countries where Apple's PC share is tiny. The best case is the U.S., where it might be 5% to 6%. In many countries it's not even a 10th of that.

They do the hardware and software together, which is sometimes useful and sometimes not. We're much more about enabling partner innovation. You might say, hmm, that's why the Windows PC has 95% market share. But Apple does good stuff.

Would you buy an Apple iPhone at \$499 or \$599?

Well, of course, I'm the wrong person to ask. I like to dial numbers with one hand, and maybe I'm the only one. The phone space is one where we think software will be the critical element. If there's anything good about the iPhone, it's software. How many companies in the world can do really great software? Will Nokia step up to a world where software is super-important? It's not clear. Will Sony? Well, they're trying, but so far it's been tough for them.

So the key trend to look at is the

importance of software and then say who really has shown the ability to do strong software. In some ways, just have. If you define more broadly, y Apple has done a few things well. Google has done a few things well. But the leaps in software and the kind of long-term investment we're making make clearer than ever the

we picked the right business, and the right place to contribute.

People are talking a lot these days about software as a Web-delivered service. I've even heard people say, "Oh, this is the last Windows of this type—a big, monolithic piece of software." Is that true?

There certainly will be major new releases of Windows as we get things like speech, and vision, and more advanced capabilities. The fact that an operating system connects out to Internet services that absolutely is the future, too, and that's our Live [Web-delivered software] initiative. You're already seeing things along those lines, like Office Live.

But, as far as I can see into the future, there will be a need every three years or so to take the world's most used, most important piece of software and take it to a new level, because that's what lets the hardware partners and the application partners—where we have 10 times many applications in Windows as anywhere else—that's what lets them build on top of what we've done.

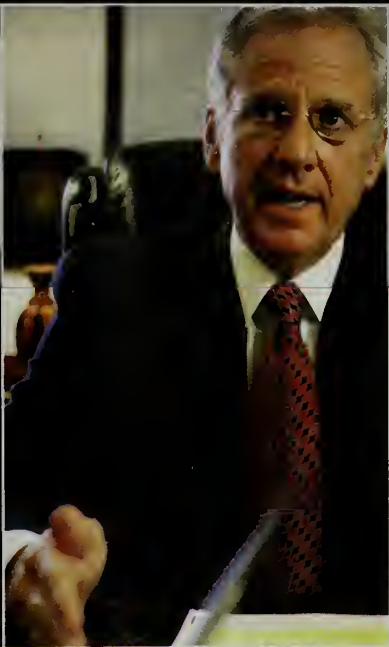
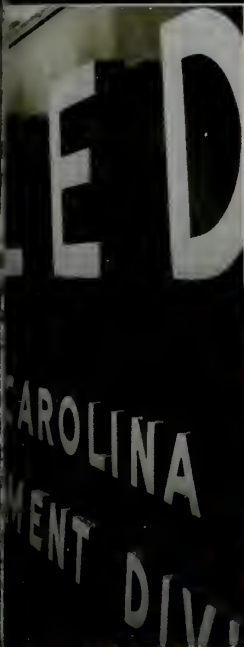
This might be one of the last major launches for you before you go off and focus on philanthropy. Are you going to miss this?

Sure, a day like today is a lot of fun. Hopefully, I'll have a day in the future where I'm launching a malaria vaccine and that will be fun. When I go part time, [Microsoft CEO] Steve Ballmer will pick a few projects for me—maybe something to do with search or Tablet PC. We have more than a year to decide that. So there are some launches that might be appropriate to roll out the old guy and have him say a few sagittations. ■

Hitachi true stories

A NEW BREED OF BLOODHOUND

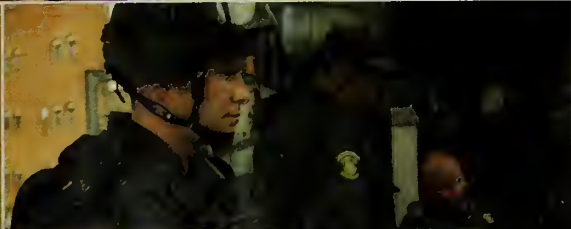
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MEDICINE

STEM-CELL REFUGEES

Yanks are flocking to China for therapy

BY BRUCE EINHORN

AUGUST, 2002. CHUCK Melton, a burly 24-year-old factory worker, is living a good life in southern Illinois. He has a growing family: Son Blake is 3 and daughter Bailey is 1. An outdoorsman, Melton fishes, hunts deer, and rides four-wheelers at all-terrain-vehicle parks. Today he has gone for a swim with some friends in a local lake. His pals dive in, and then Melton does, too. But something is wrong about the way he enters the water. Instead of dipping lightly beneath the surface like the others, he strikes his head on the bottom.

A few hours later, at a hospital in St. Louis, he receives the grim news: His spinal cord is severely injured, and he is paralyzed from the chest down. In the ensuing months, he learns what life is like in a wheelchair, suffering uncontrollable leg spasms 20 to 30 times a day.

The injury also affects his body's internal controls. He loses the ability to perspire, so he can't be outside during the summer months for more than a few minutes.

GOVERNMENT SUPPORT

FLASH FORWARD 4½ years. Melton is in Shenzhen, a city in Southern China. He has checked into Nanshan Hospital for a treatment that will place him on the frontiers of modern medicine. In the operating room, Chinese doctors have put a needle into Melton's spinal cord and inserted stem cells isolated from umbilical cord blood. Their goal is to accomplish what no doctor in the U.S. has done: to give Melton hope that his condition is not permanent. "I would love to be able to walk again," he says. "But I look at anything as an improvement."

One week into his treatment, he's pleased with the results. His leg spasms have pretty much disappeared, and during the acupuncture treatment he can feel heat in his muscles. "It is an absolutely wonderful and blessed feeling," he writes in his blog, "to continue to see and feel small changes of recovery."

The treatment that Melton is getting is unavailable in the U.S. but increasingly popular in China. In this nation, "stem cells" aren't fighting words.

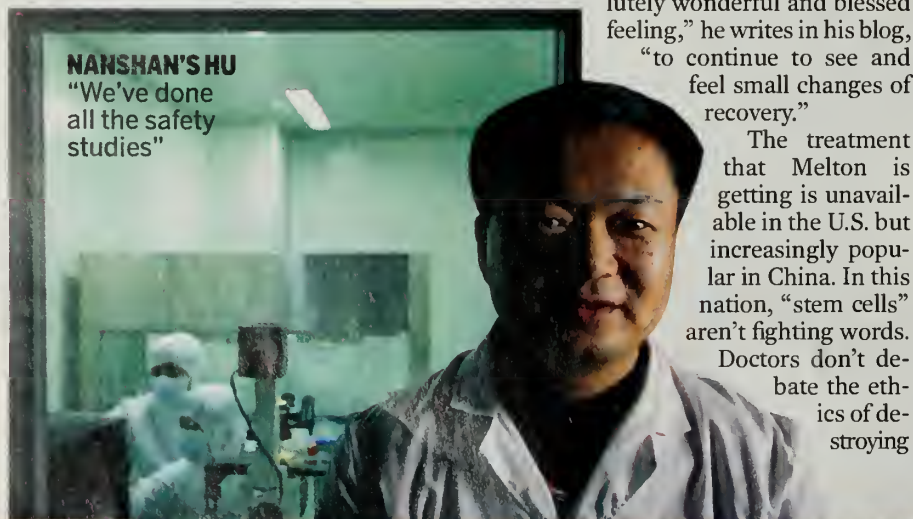
Doctors don't debate the ethics of destroying

day-old embryos to harvest the cells. And with the tacit support of government regulators, physicians are more adventurous than Western doctors in treating patients with stem cells extracted from aborted fetuses and from umbilical cords.

In the U.S., doctors have only injected small groups of people with stem cells from fetuses or cord blood as part of clinical trials. And even in test environment the most versatile embryonic stem cells aren't used on humans because they're too hard to control. In animal test stem cells have been known to morph into tooth and hair cells—something

MELTON
After treatment
in Shenzhen, "a
blessed feeling"

NANSHAN'S HU
"We've done
all the safety
studies"





ou definitely don't want in a heart or a brain. It could be years before the U.S. Food & Drug Administration gathers enough data to declare stem-cell therapies safe and effective. Not even celebrity advocates such as Michael J. Fox or the late Christopher Reeve have argued for raising trials in order to treat patients right now.

Many doctors in the West therefore believe patients like Chuck Melton should stay put in the U.S. The Chinese doctors can't prove their treatments work because "they don't have statistically valid sample sizes and there are no con-

trol subjects," says Dr. John D. Steeves, professor at the University of British Columbia and co-author of a recent paper in the journal *Spinal Cord*, which offers guidelines for clinical trials involving stem cells. "The way Chinese doctors are doing this means nobody will learn anything," he complains. "It won't help them, it won't help us, it won't help the medical community." Dr. Robert Lanza, vice-president for research and scientific development at Advanced Cell Technology, an Alameda (Calif.) company that is a leader in embryonic stem-cell research, says he's "very concerned.... A lot of pa-

tients could get exploited. To go overseas for therapies that are not up to standards required in countries such as the U.S. could be dangerous."

Chinese doctors insist the concerns are overblown. Experience has already shown there's no danger with umbilical cord stem cells, argues Dr. Sean Hu, chairman of Shenzhen Beike Biotechnology Co., a company that works with Nanshan Hospital to provide Chuck Melton with his treatment. "We've done all the safety studies," says Dr. Hu, who compares what he and other Chinese physicians are doing to bone marrow transplants. "If the doctor is qualified and the hospital is qualified, then they should be allowed to do this." In addition to helping patients, Hu believes his work will give China a competitive edge in an important new area of medicine. And he talks about building a global network, with centers in Latin America and Eastern Europe.

SUCCESS STORIES

GOOD OR BAD, China's clinical work is already cutting-edge. More than 100 Chinese hospitals are currently performing stem cell procedures, according to Jon Hakim, a Minnesota native who has been appointed director of the foreign patient services department at Beike, helping Nanshan Hospital recruit patients. Since opening up to foreigners about a year ago, Beike has treated 170 of them from 29 countries. Like Melton, most of them find out about Beike from the Internet, and many write their own blogs in China and after they return home. In addition to spinal cord injuries, doctors treat multiple sclerosis, cerebral palsy, and ataxia, a genetic disease that leads to deterioration of muscle function. While undergoing stem cell treatment, patients may also receive physical therapy, acupuncture, massage, drugs, and electrical stimulation. The average price tag: \$17,000, plus airfare.

Melton and his fellow patients have heard the warnings from Western doctors. But they have also read about Beike's success stories, and with doctors at home not offering them any hope, they're willing to take their chances and ignore the critics. "People like that, they're not living with what I'm living with," says Rachel Lane, a former schoolteacher from New South Wales. She has ataxia and had to give up teaching when the illness caused her to slur her words. "People think I'm drunk," she says bitterly.

Dr. Hu contends that doctors have an obligation to help such patients. "If

you say wait [for clinical trials], these patients will lose the chance," he says. To meet the objections of Western doctors, though, he is now hoping to start clinical trials for his treatment. "We know it is safe and effective. Now we're going to prove it," he says.

Western doctors may be difficult to persuade. Dr. Susan Perlman, a clinical professor of neurology at University of California at Los Angeles, cared for one patient before and after his stem-cell treatments in China. She confirms there were modest but medi-

cally significant improvements, but the results didn't last. Perlman notes that the multifaceted nature of the treatments patients receive in China makes it hard to assess the benefits from stem cells. With ataxia patients, for example, "it is well known that improvements can be achieved with aggressive physical therapy," she says. Stem cells also carry certain risks, Perlman says, noting that brain tumor growth was observed in a patient with Huntington's disease who was treated with fetal stem cells.

Chuck Melton isn't hesitating. He describes one night, shortly after his first injection, that he woke up with a feeling he hadn't experienced in years. "My pillow was wet, my hair was wet, my neck was wet," he says. For the first time since his accident, Melton was sweating. Almost had tears in my eyes." Melton wants to complete his treatment before Chinese New Year in mid-February. And despite the well-grounded scientific concerns of Western doctors, he's already planning a return visit next year. ■

—With Arlene Weintraub in New York

CURRENCY SLIDE

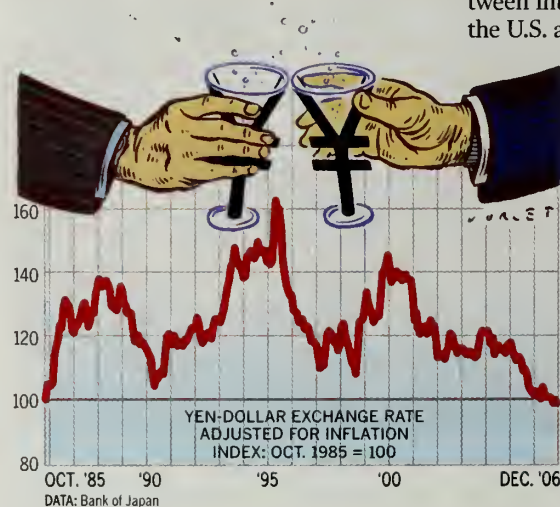
WHO'S CASHING IN ON THE WEAK YEN

Exporters' profits are getting a pop, and Japanese retail investors are betting big

BY IAN ROWLEY

AMERICAN POLICY-makers don't miss an opportunity to browbeat Beijing about the undervalued yuan. But maybe Tokyo needs a talking-to as well. In recent weeks the yen has dropped to a four-year low against the dollar and a record low vs. the euro. If you take into account the different inflation rates in the U.S. and Japan, the Japanese currency is now weaker against the greenback than it was in the mid-'80s, when the issue stoked trade tensions. "People were complaining about the extreme competitiveness of the yen at that time," says Richard Jeram, chief economist at broker Macquarie Securities in Tokyo. "And we're basically in the same situation today."

All the grousing two decades ago led to the 1985 Plaza Accord. Under that deal, Japan and Europe acted in concert to boost their currencies against the dollar. Don't expect such a large-scale reaction this time around. The U.S. has yet to exert much pressure on Japan, though the swooning yen will probably be discussed



when finance ministers from the Group of Seven meet in Germany on Feb. 9 and 10. One reason Washington isn't complaining is that Japan, unlike China, isn't manipulating its currency. "The current yen weakness isn't supported by intervention," says Masaaki Kanno, chief economist at JPMorgan Securities in Tokyo.

The feeble yen is yielding an unexpected windfall for Japanese exporters. At a time when Detroit is struggling to turn a profit, a one-yen depreciation in the dol-

lar exchange rate increases the value of Japanese auto exports to the U.S. by \$4 million, Shinsei Securities estimates. A game maker Nintendo Co. based its projections for this fiscal year on rates of 110 yen per dollar and 143 to the euro. With the currency now trading well above those levels, analysts say Nintendo's bottom line could get a \$330 million lift when overseas profits are converted back into yen.

NO SHORTAGE OF SHORTS

WHY IS THE YEN in a slump? Japan, after all, is in the midst of its longest expansion since World War II. Economists say the yen's weakness stems from the gulf between interest rates in Japan and those in the U.S. and Europe. The benchmark rate

in Japan stands at just 0.25% compared with 5.25% in the U.S. and 3.5% in the euro zone. The differential has fueled a boom in what is known as the "carry trade," wherein investors borrow yen to buy higher yield assets overseas. Japanese retail investors are also getting out of the yen and now have around \$210 billion in mutual funds denominated in other currencies, says Kenji Yumoto, chief economist at Japan Research Institute in Tokyo. "These investments are risky, but the numbers keep growing," Yumoto says.

The yen doesn't appear likely to rebound soon. Short yen positions—where investors bet that the currency will weaken—have reached record levels, according to the U.S. Commodity Futures Trading Commission. A sudden realignment is unlikely as long as the Bank of Japan holds rates steady, as it did on Jan. 1. And with soft consumer spending and virtually no inflation, it's anyone's guess when Japan's money men might give the yen a boost. ■



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SLEEK The 2008 Nissan Altima Coupe

AUTOS

PUTTING FORD IN THE REARVIEW MIRROR

Carlos Ghosn's repair job could make Renault-Nissan the world's No. 3 carmaker

BY GAIL EDMONDSON

JUST ABOUT EVERYONE IN the auto industry knows that Toyota Motor Corp. is on pace to pull ahead of General Motors Corp. as the world's largest carmaker this year or next. But less noticed has been a race just down the ranking tables, where another storied U.S. giant is facing similar pressure: Ford Motor Co. is on the verge of being edged out by Renault-Nissan for the No. 3 spot globally. As Ford shrinks to projected sales of 6.3 million vehicles for 2007, the French-Japanese alliance is likely to grow to 6.4 million, according to data from Morgan Stanley and UBS.

Ford's catastrophic \$12.7 billion loss in 2006, and impending production cuts this year, have shifted it into reverse, letting Renault-Nissan catch up fast. (Ford owns 33% of Mazda, which sold 1.3 million cars last year, but doesn't include those sales in its total.) Carlos Ghosn, chief executive at both Renault and Nissan, has pushed the

two companies to collaborate on engineering and research and development. It's a formula that seems to be working. As Detroit has struggled, Ghosn has quietly boosted design and quality, cut costs, and attacked high-growth Asian markets.

It hasn't always been easy for Ghosn, who saved Nissan from near-bankruptcy in 1999. Last year was filled with setbacks and troublesome distractions, such as failed talks on expanding the Renault-Nissan alliance to include GM. Ghosn ordered improvements in new models, causing costly delays. But getting it right was essential, especially in the wake of earlier quality problems. All told, 2006 sales for the Renault-Nissan alliance fell 3.6% worldwide.

Now the repair work seems largely done, and both companies are poised

to rebound. Nissan's U.S. third-quarter sales rose 1%, reversing a first-half slide. For the next fiscal year, Nissan's global sales will rise 7%, Standard & Poor's forecasts. That's largely thanks to the launch of nine new models, including revamped versions of high-volume cars such as the Altima, Sentra, and Infiniti G35 sedan. Renault's global sales are also expected to jump 7% this year, Morgan Stanley estimates, as the Twingo subcompact revamped Laguna sedan, and a minivan version of the low-cost Logan all hit the market. That should help Ghosn start delivering on his promise of 6% margins at Renault in 2009.

ONE PLATFORM, MANY MODELS

THE LOGAN IS KEY to Ghosn's push into emerging markets. Competitors had dismissed the \$7,500 compact, built in Romania, as an underpowered, low-margin ugly duckling. Yet it went on to be a hit following its 2004 launch. Last year sales jumped to 247,000, and Ghosn aims to sell 1 million Logans worldwide in 2010, many of them in India and China. Renault also aims to produce a low-cost pickup based on the Logan for South America, the Middle East, and Southeast Asia. As the new models roll off the assembly line, many expect Ghosn's restructuring to start kicking in. Says David Weinstein, a professor at the French business school INSEAD: "The real dimensions of the Renault-Nissan iceberg are not yet visible."

Renault-Nissan's strategy of designing many models from one platform gives the alliance an edge. In 2007, Renault will introduce a new generation of its Megane compact family based on Nissan's Rogue and Qashqai crossover SUVs. With the Megane family accounting for about half of Renault's sales and 75% of its profit, the shared platform will especially help the bottom line.

THE STAT

6.4 million

Number of autos Renault-Nissan is expected to sell in 2007, vs. Ford's 6.3 million

Data: Morgan Stanley, UBS

The complementary reach of Renault and Nissan lets Ghosn carry out a surprisingly powerful global strategy. Nissan is strong in Japan, China, and the U.S., where Renault is a market leader in Europe and spearheading the push in India. "As a result, they can play bigger than they are," says Morgan Stanley analyst Adam Jones. "Their ultimate competitor is Toyota." ■

—With Ian Rowland in Tokyo

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Carlyle Changes Its Stripes

By diversifying into a broad range of assets and deals, it aims to flourish long after the buyout boom fizzles

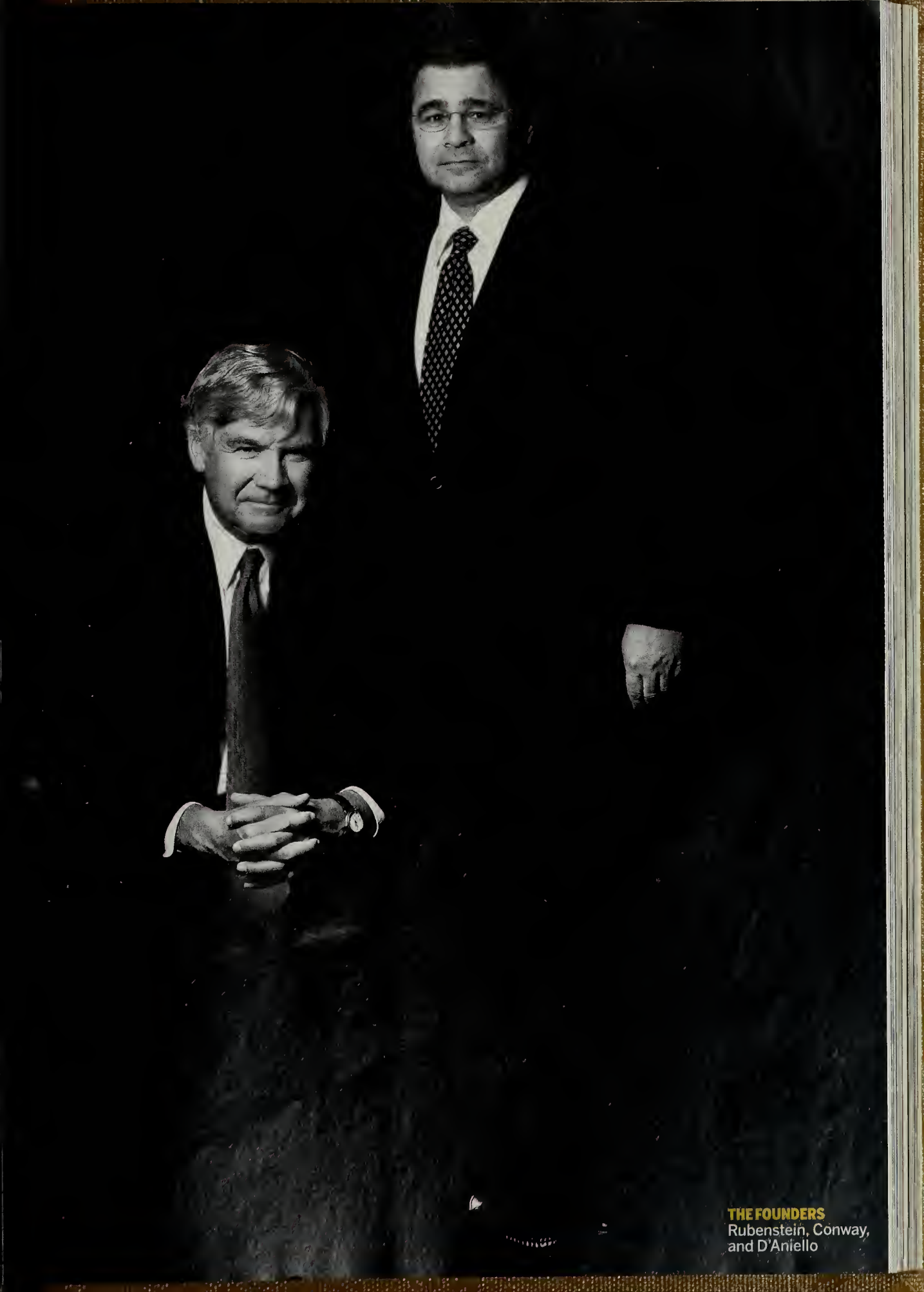
BY EMILY THORNTON

IN THE TWO DECADES SINCE PRIVATE EQUITY firms first stormed the business world, they've been called a lot of things, from raiders to barbarians. But only one firm has been tagged in the popular imagination with warmongering, treason, and acting as cold-eyed architects of government conspiracies. The broadsides got to be more than David M. Rubenstein, William E. Conway Jr., and Daniel A. D'Aniello, founders of Washington's Carlyle Group, could take. "It was nauseating," Rubenstein says.

Carlyle, founded 20 years ago in the shadow of Washington's power centers, long went about its business far from the public eye. Its ranks were larded with the politically connected, including former Presidents, Cabinet members, even former British Prime Minister John Major. It used its partners' collective relationships to build a lucrative business buying, transforming, and selling



PHOTOGRAPHS BY LEN IRISH;
DIGITAL COMPOSITE BY NEAL FONTANA/BW



THE FOUNDERS
Rubenstein, Conway,
and D'Aniello

companies—particularly defense companies that did business with governments.

Carlyle might have continued happily in that niche except for the confluence of three events. First there were the terrorist attacks of September 11. In the aftermath, conspiracy theorists seized on Carlyle's huge profits, intense secrecy, and close dealings with wealthy Saudi investors. The scrutiny reached a crescendo in Michael Moore's documentary *Fahrenheit 9/11*, which made Carlyle seem like the sort of company image-conscious investors like public pension funds might choose to avoid. The second factor was the tsunami of capital that has been sloshing around the globe for five years, providing almost limitless funding for the kind of dealmaking that is Carlyle's specialty. All that liquidity has brought with it immense opportunity as well as stiff new competition. Finally, there's the succession issue. Carlyle's baby boomer founders can see retirement around the corner. And they badly want the firm, their legacy, to outlast them.

At this make-or-break juncture, Carlyle's founders, billionaires all, decided to refashion their firm radically—to transform it into something more ambitious, more diverse, and more lasting.

Stage I of what some have dubbed the Great Experiment was largely cosmetic. The founders asked members of the bin Laden family to take back their money. They sat down with George H.W. Bush and John Major and discussed, improbable though it might seem, how the two were no longer wanted as senior advisers because they hurt the firm's image. Out went former Reagan Defense Secretary Frank C. Carlucci as chairman. In came highly regarded former chairman and CEO of IBM, Louis V. Gerstner Jr., along with former Securities & Exchange Commission Chairman Arthur Levitt, former

By the end of the year, **Carlyle expects to have an unprecedented \$85 billion** under management—and Rubenstein sees that swelling to as much as \$300 billion by 2012.

General Electric Vice-Chairman David Calhoun, and former Time Inc. Editor-in-Chief Norman Pearlstine, among others, to underscore Carlyle's commitment to portfolio diversification and upright corporate citizenship. Carlyle also pared back defense holdings dramatically.

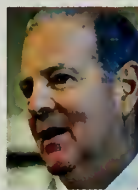
Stage II went much further and, indeed, might come to redefine the very nature of private equity. While other major buyout firms raise a few massive funds that hunt big prey—companies they can take private, rejigger financially, and, eventually, sell off or take public again—Carlyle has spread its money among no fewer than 48 funds around the world. Whereas the other giant firms—Blackstone Group, Kohlberg Kravis Roberts, and Texas Pacific Group—manage just 14, 7, and 6 funds, respectively, according to Thomson Financial, Carlyle launched mind-boggling 11 in 2005 and 11 more in 2006.

More important, Carlyle now deals in a broad swath of alternative assets that include venture capital, real estate, collateralized debt obligations, and other investing exoticia, which now make up a third of its assets. Rubenstein expects that percentage to grow to half by 2012. By getting into so many different areas, Carlyle seeks to exploit lucrative opportunities now and gain flexibility later when the booming buyout market slumps.

FRESH FACES AT CARLYLE

Once known for its high-profile political connections, Carlyle has recently added several new faces to its leadership team.

THEN



Former President GEORGE H.W. BUSH (far left) joined in 1998 as a senior adviser. He retired in 2004 but still has some investments in Carlyle.



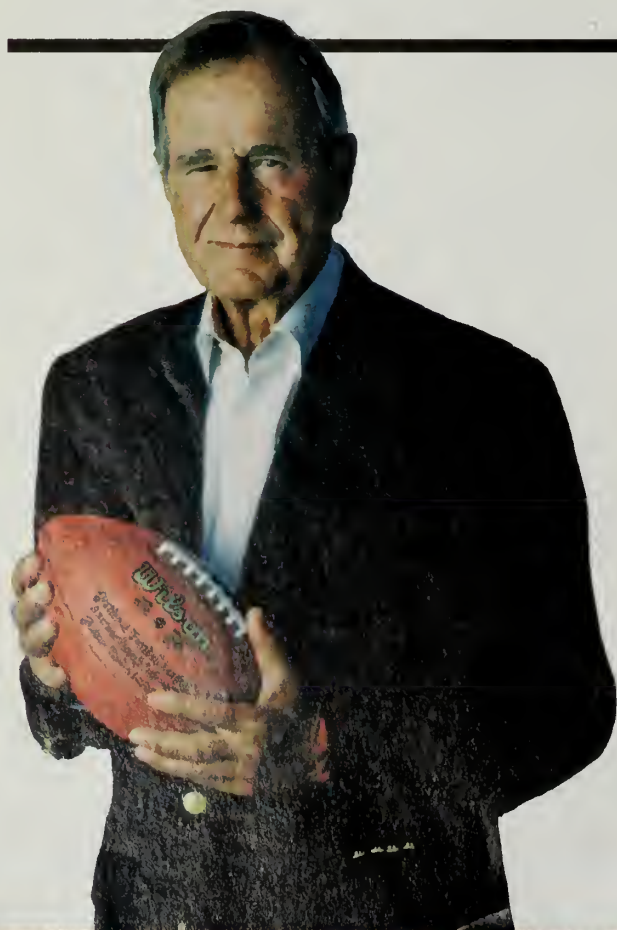
Former Secretary of State JAMES A. BAKER III became a senior counselor and partner in 1993 and retired from his position in 2005. He is no longer a partner or an adviser.



President GEORGE W. BUSH served as a director on the board of Caterair, a Carlyle portfolio company, for several years in the early 1990s. He resigned in 1994 to run for governor of Texas.

Former Secretary of Defense FRANK C. CARLUCCI joined in 1989 as vice-chairman and served as chairman from 1992-2003. He retired from his position as chairman emeritus in 2005.

Former British Prime Minister JOHN MAJOR became chairman of Carlyle Europe in 2001 and retired in May, 2004. He remained on Carlyle's advisory boards until June, 2005.



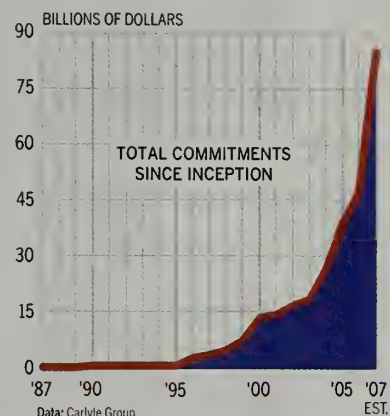
The risk lies in getting it right. Having never managed such disparate assets before, Carlyle is on a steep learning curve. And it will be competing with traders and managers who have seen every kind of market—up, down, sideways.

Carlyle's radical makeover has turned the firm into the biggest fund-raising juggernaut the private equity world has ever seen. By the end of this year it expects to have an unprecedented \$85 billion in investor commitments under management, up sixfold from 2001 and more than any other firm expects. Rubenstein sees the total swelling to as much as \$300 billion by 2012. This year alone, Carlyle plans to raise a record \$34 billion. Thanks to the surging debt markets, which are pumping up leveraged buyouts, that easily translates into more than

\$200 billion in purchasing power, enough for Carlyle to take it, say, Yahoo!, Caterpillar, and FedEx and still have \$100 billion left over. "People probably look at them with a bit of envy," says Joncarlo Mark, a senior portfolio manager at California Public Employees' Retirement System (CalPERS), which owns 5% of the firm. Texas Pacific co-founder David Bonderman considers Conway, Carlyle's chief investment officer, "one of the best in our business."

So what, exactly, is Carlyle? Part buyout shop, part investment bank, part asset-management firm, it has set out on its own course all its own. "There are going to be some major financial institutions that emerge from the phenomenal growth [in

MONEY, MONEY, MONEY



announce it. Bespectacled and tightly wound, Rubenstein, 57, sits behind a dark mahogany desk so spare it's hard to believe he ever uses it. And the place has none of the typical trappings of the private equity elite. No photographs of Rubenstein with famous people (though he knows plenty). No artwork. No "love me" collages of degrees and awards. "[Carlyle] is a serious money-management business," says Rubenstein, "and we have to operate it that way if it's to have duration beyond the founders." Besides, he says, his austere offices in Washington and New York serve as reminders that he could lose everything at any moment. "I don't have things on the walls because I might have to take them down," he says. Rubenstein is ascetic

private equity] of the last years," says Colin Blaydon, director of the Center for Private Equity & Entrepreneurship at Dartmouth's Tuck School of Business. "Carlyle is very deliberately moving in that direction. It looks a bit like the mid-'80s, when a handful of big, multiline investment-banking firms emerged as the bulge bracket."

Make no mistake—Carlyle is already massive. It owns nearly 200 companies that generate a combined \$68 billion in revenue and employ 200,000 people. Last year it bought a new company approximately once every three days and sold one almost once a week—all while dabbling in increasingly esoteric investments.

Such feats might qualify Rubenstein for Master of the Universe status, but his New York office certainly doesn't an-

CARLYLE GROUP

has been seeking out executives and technocrats.

NOW

Former IBM Chairman and CEO

LOUIS V. GERSTNER JR. (right) joined Carlyle in 2003 as chairman. He sits on the main investment committee and offers management advice.

« **Former SEC Chairman ARTHUR LEVITT**

came on as a senior adviser in 2001.

« **Former Bank of America Chief Financial Officer**

JAMES H. HANCE joined in 2005 as a senior adviser on the financial-service sector.

Former General Electric Vice-Chairman

DAVID L. CALHOUN became chairman and CEO of VNU Group, renamed Nielsen Co., on Jan. 18. It is owned by Carlyle and partners.

« **Former Time Inc. Editor-in-Chief**

NORMAN PEARLSTINE joined in 2006 as a senior adviser to its telecommunications and media team.

Data: Carlyle Group



(RIGHT) BRIAN SMITH; (TOP TO BOTTOM) NELVIN C. CEPEDA/SDU-T/ZUMA PRESS; DANIEL ACKER/BLOOMBERG NEWS; FRANK FRANKLIN II/AP PHOTO

by nature. He shuns red meat, avoids alcohol and desserts, and limits his business attire to navy pin-striped suits.

Rubenstein doesn't have much time to gaze at the walls anyway. With money flowing in so fast and opportunities increasing exponentially, the firm's expansion is creating problems buyout shops have never had to deal with before.

Coping with the hypergrowth is Stage III of the Great Experiment. Carlyle has overhauled its management structure, decentralizing decision-making in a way that would shock the typical larger-than-life buyout baron. Now, instead of relying on the founders to bless every deal, it sprinkles investment committees around the firm, each made up of managers from different funds and backgrounds. Before memos reach the top, they have to make it through each fund's committee. If a big deal in, say, Japan, looks tempting, the Japan fund might solicit money from bigger Carlyle funds, which perform their own due diligence. This is management more along the lines of a professionally run, shareholder-owned corporation than a private partnership where the founders' dictates, wise or not, carry the force of law. In the annals of business, it's the juncture at which many a hot boutique has failed. Rubenstein says big private equity firms, including his own, will one day be publicly held.

The new setup allows Carlyle's founders, known inside the



BIGGER PREY

Carlyle's major deals announced since 2004*

TARGET COMPANY / YEAR	VALUE (BILLIONS)
KINDER MORGAN 2006 Energy infrastructure provider	\$27.5
FREESCALE SEMICONDUCTOR 2006 Semiconductor maker	17.5
VNU GROUP** 2006 Information and media company	11.3
ADVANCED SEMICONDUCTOR 2006 Transistor and diode producer	6.2
HERTZ 2005 Rental-car company	5.6
PANAMSAT 2004 Satellite-services company	4.6
INSIGHT COMMUNICATIONS 2005 Cable company	3.3
DUNKIN' BRANDS 2005 Restaurant franchiser	2.4

*Includes deals involving partner firms **Renamed Nielsen Co.
Data: Thomson Financial Corp.

firm as "DBD" for David-Bill-Daniel, to concentrate on what they do best. Rubenstein travels the globe 260 days a year to raise funds. The fiery Conway, 57, scrambles to put the money to work. D'Aniello, 60, is chief operating officer and, in many ways, the glue of the operation. Underneath DBD and Chairman Gerstner, a web of investment managers run money while seasoned executives not only manage companies but beat the bushes looking for deals. Carlyle estimates that any one time it has headhunters conducting 10 to 15 searches for high-level talent. When Carlyle and its partners landed Carhoun, they were willing to pay him \$100 million. Carlyle has promoted 50 of its people to the level of partner—a path that typically takes 12 years. Below them sit associates, who earn about \$150,000 to start.

Central to Carlyle's Great Experiment is old-fashioned risk management. The more diverse the assets, say finance textbooks, the better the risk-adjusted returns. Carlyle has long been known as one of the most risk-averse of the major firms. Its main U.S. buyout fund has lost money on only 4% of its investments, making it one of the most consistent performers in an industry that typically sees losses on 10% to 15% of its positions, according to Hamilton Lane, an institutional money management and advisory firm. Thus far, Carlyle's aversion to risk hasn't come at the expense of returns. Quite the opposite. Since its founding in 1987 it has generated annualized after-fee returns of 26%, compared with the industry average in the mid-teens. But already, DBD is telling investors they shouldn't expect private equity returns of 30% a year to continue.

Carlyle's longtime focus on small and midmarket deals—less than \$1 billion—has also set it apart from the other megafirms. In buyouts, KKR and Blackstone concentrate on the biggest acquisitions, while Texas Pacific Group is known for doing difficult deals that other firms won't touch. Carlyle's specialty is turning small deals into big successes. Even its most ardent former skeptic praises the approach. Stephen L. Norris, one of the firm's original five founders, split in 1995 in a bitter fight over Carlyle's direction. "I was wrong," Norris says flatly. "David is a billionaire, and I'm not." (The other original partner, Greg A. Rosenbaum, left during the first year.)

But overheated debt markets have changed Carlyle's formula, at least for now. When interest rates plunged earlier in the decade, deal financing got much cheaper, and Carlyle too

QUICK FLIP Carlyle and its partners took Hertz private for six months, then took it public again

The digital world is a beautiful thing.

There is an endless supply of more.
More music. More videos. More...stuff.

It's exciting (and a little overwhelming).

The thing is, managing all this stuff is
getting more complicated.

Music and pictures. E-mail and blog feeds.
JPEGs and PDFs everywhere.

We want all this stuff, but we want it simplified.

So. What if everything could become
instantly streamlined, easy to navigate,
and who knows, even more fun?



What if, instead of being
overwhelmed, you suddenly felt
a whole new kind of feeling?



Introducing Windows Vista.™ The "Wow" starts now. To learn more, visit WindowsVista.com.

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BIO BOX CARLYLE'S FOUNDERS



DAVID M. RUBENSTEIN

BORN 1949, Baltimore, Md.

CHILDHOOD Only child. Father was a postal worker; mother was a clothing salesperson.

EDUCATION BA, political science, Duke University, 1970; JD, University of Chicago Law School, 1973.

FIRST JOB Door-to-door magazine salesman while in high school.

CAREER Practiced law in New York. Became Deputy Assistant to the President for domestic policy in the

Carter Administration. Practiced law in Washington before co-founding Carlyle Group in 1987.

FAMILY Met wife, Alice, while both worked for the Carter Administration. She chairs a group promoting native Alaskan art. Two daughters and a son.

LIFESTYLE Travels 260 days a year. Reads 10 newspapers a day. Does not smoke, drink alcohol, or eat red meat.

INTERESTS Serves on the boards and advisory committees of 25 nonprofit groups, including the Asia Society and Memorial Sloan-Kettering Cancer Center.



WILLIAM E. CONWAY JR.

BORN 1949, Lowell, Mass.

CHILDHOOD Eldest of five children. Father was CEO of Nashua Corp.

EDUCATION BA, economics, Dartmouth University, 1971; MBA, University of Chicago, 1974.

CAREER Worked for almost 10 years at First National Bank of Chicago in corporate finance and commercial

lending. Joined MCI Communications in 1981 as treasurer and became chief financial officer in 1984. Left three years later to co-found Carlyle.

FAMILY Married to second wife, Joanne. One son, a prosecutor.

INTERESTS Supporter of various local charities. With his wife, created Bedford Falls Foundation, named after the town in the movie *It's a Wonderful Life*.



DANIEL A. D'ANIELLO

BORN 1946, Butler, Pa.

CHILDHOOD Only child. Raised by his mother, an insurance claims agent, after his father died when D'Aniello was eight years old.

EDUCATION BA, transportation economics, Syracuse University, 1968; MBA, Harvard, 1974.

FIRST JOB Stock boy at a grocery store at age nine.

CAREER Financial officer at Trans World Airlines until 1976, and then at PepsiCo until 1980. Vice-president for finance and development at Marriott before co-founding Carlyle in '87.

FAMILY Met wife, Gayle, through a mutual friend when she was a paralegal. Two daughters.

INTERESTS Established an entrepreneurship program at Syracuse.

FAVORITE MOVIE *Rudy*, 1993

opportunities to refinance debt will disappear. Cash flows will shrivel. There will be bankruptcies.

Carlyle has a longer and more lustrous record than most firms, but there's no doubt it's getting increasingly audacious in its financial footwork. In June, along with partners Clayton, Dubilier & Rice and Merrill Lynch, it collected an unprecedented \$1 billion dividend from rental-car company Hertz just six months after taking it private for \$15 billion—and then promptly took it public again, a lightning-quick flip in buyout land. Carlyle estimates it has already earned back 54% of its \$765 million investment and points out that it and its partners still own 71% of the company and are managing it for the long term.

Conway makes no apologies for returning money to investors—institutions, pension funds, and wealthy individuals—as quickly as possible. He's paid to spot opportunities and seize them. For example, in 2002, Carlyle beat a pack of other firms to buy the Dex Media Yellow Pages Div. from struggling Qwest Communications International for \$7 billion with partner Welsh, Carson, Anderson & Stowe. Then the largest buyout since RJR Nabisco, the deal was beset by regulatory hurdles and was ultimately carried out in two stages. (Carlyle made 2.6 times its investment when it took Dex public in 2004 and exited last year.)

When Stephen A. Schwarzman, CEO of Blackstone Group, called Rubenstein last August to gauge his interest in Austin (Tex.)-based Freescale Semiconductor, Carlyle's Great Experiment was put to the

full advantage, making successively bigger purchases (chart). Founder Conway acknowledges the worry. "Our business right now is being propelled by the rocket fuel of cheap debt," he says. "Rocket fuel is explosive, and you have to be careful how you handle it." Daniel F. Akerson, co-head of the firm's U.S. buyout fund, says one bank last year offered to give Carlyle twice the financing it needed for an acquisition. "That's when you say to yourself: 'Wow.' That's the craziness of it."

test. Schwarzman gave Carlyle only a few weeks to decide. So 40 investment professionals from the firm's U.S., Asian, Japanese, and European buyout funds got to work. They probed Freescale's ability to service its clients worldwide, researched its management team, and wrestled with the risks involved in the company's valuation, which had more than doubled in two years. Buyouts of tech companies, with their high capital expenditures and boom-and-bust product cycles, have been rare. Ultimately, the group decided the deal was worth the risk, and Carlyle bid alongside Blackstone.

Such moves have raised red flags among regulators. Carlyle is one of several firms that received letters from the Justice Dept. last fall asking for information on club deals. And the firm's sprawling portfolio is beginning to raise eyebrows, too. On Jan. 25 the Federal Trade Commission told Carlyle it could complete a \$27.5 billion buyout of energy-distribution holding company Kinder Morgan Inc. only if it agrees to give up operational control of another company it owns. Carlyle has

Red Flags

SUCH EASY ACCESS TO CAPITAL now can set up big trouble later on. To paraphrase Alan Greenspan, the worst of deals are made at the best of times. Right now almost all dealmakers look like geniuses. But history tells us that when the cycle turns, many who are riding the current wave of hope and euphoria will be washed out to sea. If interest rates rise, op-

gotten so big and so diverse that it's actually raising antitrust concerns—a first for a buyout firm.

Back in 1987 no one would have imagined that Carlyle's founders would one day count themselves among the private equity aristocracy. Rubenstein was an unhappy lawyer whose main calling card was a stint as a domestic policy adviser in the Carter Administration. Conway had dealt with junk-bond czar Michael R. Milken as treasurer and chief financial officer of MCI Communications but had little experience buying companies. D'Aniello's expertise was handling hotel financings at Marriott Corp. "People laughed at us," Rubenstein recalls.

With a bankroll of just \$5 million, Carlyle struggled. It began by marketing Alaskan tax write-offs to corporations—hardly the stuff of Wall Street or Washington folklore. Its first attempt at a buyout turned into a painful learning experience. Carlyle hit up one of its founding investors, the Mellon family of Pittsburgh, for money to buy the restaurant chain Chi-Chi's. Then the group made a pilgrimage to Milken to get the rest of the money. They lost the auction to a company called Foodmaker and learned afterward that Milken had financed each of the four bidders. "It was stunning to us," recalls D'Aniello of his introduction to the buyout business. Milken was not available for comment.

Increasingly, Carlyle backs entrepreneurs who have little more than a patent. Case in point: An interest in a group working on a no-surgery liposuction machine

Their fortunes turned when they wooed former Defense Secretary Carlucci to the firm in 1989. He delivered a sweet deal in his first year—a defense think tank called BDM International that was involved in large projects like manned space stations and, eventually, the deployment of Operation Desert Shield. "All these little jewels were coming available from larger companies that were looking to [pare their holdings to] find their core competencies," recalls D'Aniello. Carlyle was able to sell BDM in 1997 and make its investors 10.5 times their initial stake. The firm went on to become a force in the defense industry: Carlyle was one of the nation's 15 biggest defense contractors from 1998 to 2003, according to the Pentagon.

By 2005, thanks to the diversification strategy, it wasn't even among the top 100 defense contractors. Today, investment pro-

fessionals in New York, Washington, Los Angeles, and London buy and sell loans, stocks, bonds, and other securities. The largest holdings are in secured bank loans. But on the 42nd floor of Carlyle's New York office, some now trade in the securities of deeply distressed companies—the kind that Carlyle's buyout business once refused to touch.

Across the Globe

THE SEEDS OF THAT BUSINESS were sown in 2002, when debt was getting cheaper and Managing Director Michael Zupon convinced DBD that there were profitable opportunities in distressed companies. He had taken a position in the bond of an aerospace company at less than 50¢ on the dollar, and the company's executives pitched him on buying preferred stock. Keenly aware of Carlyle's expertise in aerospace, Zupon consulted with one of the firm's senior dealmakers in the sector. The two decided that Carlyle's high-yield fund and its U.S. buyout fund should buy the \$15 million stake. Its value soared to \$45 million in 18 months. "That was the catalyst," Zupon says. The business has since expanded into buying companies outright. One of the group's first purchases was titanium component maker Stellex Aerostructures Inc., which Carlyle had once considered acquiring. The distressed team bought it after it emerged from bankruptcy in 2004. Two years later it sold for 6.2 times what Carlyle paid.

At the other end of the investing spectrum, a group of 50 people spread out in Washington, San Francisco, Mumbai, Beijing, Shanghai, Hong Kong, and London are looking to put \$3.6 billion to work in venture and other deals. "We're seeing a set of opportunities with strong growth attributes but which just don't lend themselves to the traditional leveraged-buyout approach," explains Brooke B. Coburn, who co-heads Carlyle's American venture fund. Most of the group's investments are in small businesses and fledgling divisions carved from companies. For example, the U.S. venture group paid \$44 million for the English-as-a-second-language instruction division of publicly traded Laureate Education Inc. in 2005. Carlyle's venture team saw an chance to expand dramatically. The company's revenues have surged 70%, to more than \$120 million.

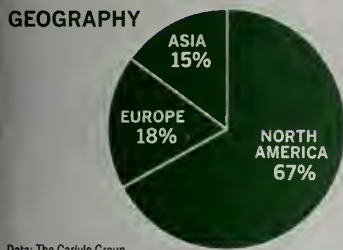
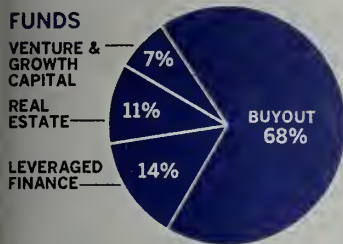
Increasingly, Carlyle is also backing entrepreneurs who have little more than a patent. One investment is with a group that patented the idea for an advanced liposuction machine. In theory it damages fat cells with ultrasound waves so they can be se-

bona fide

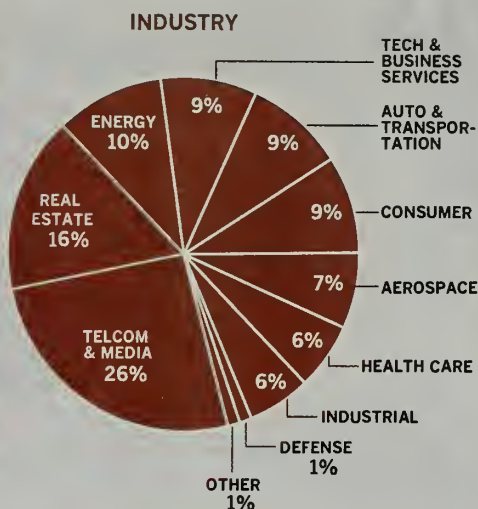
bonehead

CARLYLE'S PATH TO RICHES

It is diversifying across asset classes, industries, and locations



Data: The Carlyle Group



done exceptionally well," says CalPERS' Mark. "But you [also] have the safety net of the broader organization."

The biggest question facing Carlyle is whether it can maintain the discipline and top-notch performance it has been known for through this period of hypergrowth. The tension between Rubenstein rushing out new funds and Conway racing to find the financial expertise to keep up is palpable. Good investment professionals "don't grow on trees," Conway complains. "You talk to a headhunter who says: 'I know 50 of those people.' Then you hire the headhunter and...the 50 becomes 3."

With so much money flowing in, finding and keeping talent has become an obsession. D'Aniello, who oversees Carlyle's real estate and energy investments, has been moonlighting as the firm's management guru. He has hired human resources staff to attract top people, implemented 360-degree performance reviews, started succession

planning, instituted Carlyle's annual management retreat, and spearheaded an initiative called "One Carlyle," designed to encourage teamwork across borders and silos. What could be more corporate-sounding?

"We don't want isolationists," D'Aniello says of the employees he's trying to attract to sustain his firm long into the future. "We also don't want crybabies. And we don't want mercenaries—people who are here to put a notch on their own gun. We want people to help us build a cannon." ■

—With Dawn Kopecki in Washington,
David Polek in New York, Kenji Hall in Tokyo,
and Carol Matlack in Paris

BusinessWeek .com

FOR MORE ON CARLYLE'S MAKEOVER:

ONLINE: Let's Make a Deal See a slide show of Carlyle's biggest deals to date at www.businessweek.com/extras.

PODCAST: The Story Behind the Story Hear Executive Editor John A. Byrne's interview with Associate Editor Emily Thornton at www.businessweek.com/podcast.

perated naturally, eliminating the need for surgery. "We've been in [that investment] for five to six years, and [the company] has no revenue at this point," says Coburn. Carlyle has invested \$6.7 million.

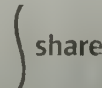
In China, Carlyle's venture fund focuses on consumer-oriented investments like Ctrip.com, the Chinese version of Travelocity. Carlyle invested \$8 million, took it public, and reaped \$117 million. In India, Carlyle is backing technology, including a company called Claris Lifesciences Ltd., which makes low-cost medicines and hospital-care products.

Carlyle may soon become even more far-flung. Its recent hiring of a team of traders from hedge fund Amaranth Advisors, which lost \$6 billion last year on bad natural gas bets, has prompted speculation that Carlyle is preparing to launch a hedge fund. There's also talk that the firm may start new buyout funds focusing on emerging markets. On Jan. 28, Carlyle announced the hiring of a dealmaker in Cairo to oversee investments in Egypt and North Africa. Citing SEC restrictions, the firm declined to comment on potential new funds.

Investors like the new, diversified approach. "The remarkable thing about the firm [is that] a lot of their funds have

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Lightspeed's Slow Start

Questions dog the new high-speed AT&T network that offers phone, Net, and TV

BY SPENCER E. ANTE

AT&T IS ON TOP OF the telecom world. A few weeks ago, chairman and CEO Edward E. Whitacre Jr. put the latest touch on his empire by closing an \$86 billion deal to acquire BellSouth. That completed a whirlwind of acquisitions in which Whitacre has virtually remade the old Ma Bell by gobbling up 13 companies over the past decade with a combined price tag of \$285 billion, including assumed debt. Last year, investors rewarded "Big Ed's" voracious appetite by bidding up AT&T's stock price 46%. The cherry on top? Well, that came last month at the Consumer Electronics Show (CES) in Las Vegas, where Cingular Wireless, the company's cell phone arm, stole the spotlight by partnering with Apple Inc. to introduce the sleek iPhone.

Now AT&T is gearing up for the next big telecom battle—for the supremacy of the Internet. AT&T's weapon of choice is Project Lightspeed, a new Internet network that sends bits of data through copper and fiber-optic cables buried in the ground. The high-speed network and its Internet-protocol television (IPTV) technology are crucial to AT&T's plan to bundle phone service, Net connections, and TV—the vaunted telecom triple play. In

theory, the system will let AT&T steal customers from rival phone giant Verizon Communications and cable companies such as Comcast and Time Warner. AT&T says it will pump \$4.6 billion into building enough fiber-optic cable and supporting technology to reach 19 million homes by the end of 2008.

But despite AT&T's stellar performance of late, the company faces serious questions about whether Project Lightspeed can deliver on its promise. Technology glitches hobbled the rollout last year. And though the TV service is up and running in fewer than a dozen markets with prices that undercut cable bills, a growing chorus of rivals, analysts, and engineers are skeptical that the network will offer enough bandwidth a few years from now to handle phone service, high-speed Internet, and multiple streams of high-definition TV.

Cable operators have taken full advantage of AT&T's slow start, gleefully swiping phone customers with their own triple-play offerings. Having invested more than \$110 billion in network upgrades over the last decade to provide Internet and digital video, cable companies only have to tweak their networks to offer phone service. As of the third quarter, the five largest U.S. cable operators have signed up about 6 million new Net-based phone customers. By contrast, AT&T and Verizon have swiped a combined

222,000 TV customers.

Verizon is placing the most ambitious and risky bet. It plans to spend \$18 billion—three times as much as AT&T—to lay fiber to every one of the 18 million homes it hopes to cover by 2010. AT&T is laying fiber into neighborhoods but is using existing copper phone lines to carry video the last few thousand feet. As a result, it will cost Verizon \$1,750 to connect each home, vs. \$450 for AT&T. Despite the higher price tag, UBS Investment Research expects Verizon to produce return on its investment by 2011. The reason? It believes the Verizon network's higher bandwidth will lure more phone, Internet, and video customers—at higher prices—and thus generate about four times as much revenue as Lightspeed. On Jan. 29, Verizon backed up the theory when it announced that it ended its first full year of operations with 207,000 TV customers, representing 9% of the 2.4 million homes capable of receiving its video service in 2006. Just a few months ago, the company was hoping to finish 2006 with 175,000 video customers.

AT&T's problems became apparent last December when it was forced to pull back on targets for its TV service. Throughout 2006, AT&T told investors that it intended to deliver TV in 15 to 20 markets by year

The Power of Video

Despite a slow start, AT&T anticipates a jump in TV revenues.

2006
\$2 million

Sales from the 15,000 subscribers signed up so far

2011
\$1.3 billion

Sales expected from 2 million subscribers

Data: UBS Investment Research





end. By November it was in just two cities, San Antonio and Houston. In the last 10 days of December, AT&T unleashed a flurry of press releases announcing it was up and running in nine more markets, including New Haven, Indianapolis, and San Francisco. Still, that's short of its original target. And UBS analyst John C. Hodulik estimates that AT&T has only 15,000 total TV customers in the 11 announced markets, generating \$2 million in revenue. The company isn't providing numbers.

It's not surprising, then, that some analysts are skeptical about another claim for Lightspeed: that two years from now, it will produce net earnings before interest, taxes, depreciation, and amortization costs are taken out. Even if AT&T succeeds in building out Lightspeed, analysts believe it will never produce a huge return from video. Rather, they say its value will be more defensive in nature—mostly to help stem phone customer defections, attract new Net customers, and make it cheaper to resolve consumer requests for adding, dropping, or changing services. Handling customer changes are the largest costs faced by a phone company. And by meeting more of those requests electronically with Lightspeed rather than sending technicians to homes, AT&T will save money. But it's far from the video

revolution that the company has been selling.

Doubts about AT&T's video project are fueling speculation it will have to buy one of the two U.S. satellite operators, DirecTV Group Inc. or EchoStar Communications Corp., to accelerate delivery of TV service. "The AT&T IPTV technology is just inferior to satellite or cable in terms of delivering video, and they don't have much time to figure it out," says Aryeh B. Bourkoff, a UBS cable and satellite analyst.

FIXING GLITCHES

ON A JAN. 25 CONFERENCE call, though, Whitacre reaffirmed AT&T's commitment to Lightspeed. "This is our Plan A, and Plan A we're sticking with," he vowed. In an e-mail interview, Whitacre said various technological fixes, such as bonding phone wires, will enable AT&T to "greatly increase bandwidth as needed." Moreover, executives claim to have solved most of the technical and customer-service problems that slowed the rollout. And they remain confident in their decision to bet on a system that's more technically complex than Verizon's, arguing it will result in a TV service superior to anything else on the market. Chris Rice, AT&T's chief technology officer, says creating broadband video "was

a lot more complex than people thought it would be. Did we have some bumps along the way? Yes. Did we solve them? Yes."

So far, AT&T TV customers seem happy. The pricing is particularly attractive, given the steep rise in cable fees. AT&T's basic package of 190 digital cable channels, a digital video recorder, and a high-speed wireless Internet link costs \$74, vs. about \$90 for a comparable cable package. Alan Weinkrantz of San Antonio, a customer since May, says compared with cable the programming guide is easier, channels change faster, and he can record four programs at once. Most cable systems allow two. "Have I had some jitter and granulation? Absolutely," says Weinkrantz. "I have had the same thing in cable. Tony Soprano froze up on me while he was about to kill someone."

But couch potatoes are not pleased by the unadvertised fact that AT&T is only supporting one high-definition TV stream per household. Services from Verizon and cable companies support multiple HDTV signals. Since the capacity of copper phone lines decreases as the wires get longer, Jean Walrand, a professor of electrical engineering and computer science at the University of California at Berkeley, says Lightspeed may not have enough bandwidth in the future when households have several HDTVs. If copper loops are "longer than a few hundred feet, the bandwidth will drop," he says. AT&T says the average length of its copper loops is 3,000 feet.

Chad Townes, vice-president and general manager of Connecticut for AT&T, told *BusinessWeek* that homes farther away from its fiber nodes can't handle multiple high-definition streams. But Rice says bonding the two copper wires that run into each home will double the bandwidth of the Lightspeed network. That's possible, Walrand says. He cautions, however, that the fix hasn't been tried in suburbs or office buildings.

In coming months, AT&T plans to roll out some whiz-bang features. Soon you'll be able to program digital video recorders from a cell phone. Deals are being struck to deliver new channels and video-on-demand. But given AT&T's history of overpromising and underachieving in TV, that may not convince skeptics that Lightspeed is ready for prime time. ■

—With Roger O. Crockett in Chicago, Jay Greene in Las Vegas, and Ronald Grover in Los Angeles

So far AT&T has fallen short of its targets



Google Steps Into Microsoft's Office

Google Apps, which lets companies offload their e-mail systems, is beefing up

BY ROBERT D. HOF

GREG BRANDEAU IS itching to dump the decade-old, homegrown e-mail system he manages at Pixar Animation Studios Inc. And the senior vice-president for technology at the Walt Disney Co. unit is sure about one thing: The replacement won't be Microsoft Corp.'s Exchange and Outlook duo, whose e-mail, calendar, and other programs dominate corporate computing. Brandeau says it's difficult to manage the software because Pixar uses a variety of computers. His

likely choice may surprise you: Google.

After months of dancing around with Web versions of e-mail, group calendars, and the like, Google Inc. is finally about to take a big leap onto Microsoft's turf. Since last August, the search leader has offered a test version of an online office productivity software suite, called Google Apps for Your Domain, that lets companies offload e-mail systems to Google while keeping their own e-mail addresses. Soon, it's expected to add word-processing and spreadsheet services to the suite, which includes an online calendar, chat service, and Web page builder. In coming weeks, Google

Apps will turn into a real business as Google begins charging corporations a subscription amounting to a few dollars per person per month. "We're dying to use something like this," says Brandeau. He's "on the cusp" signing a contract with Google.

A DIFFERENT GAME

FOR NOW, Microsoft has little to fear. Many large corporations are wary of having their e-mail system run outside their own walls, where they can't be sure it's secure from hackers and spies. And even Google concedes its services don't have all the bells and whistles of Microsoft's products, such as centralized e-mail backups that help them comply with regulatory rules. "We're not looking to make it us vs. them," swears Dave Girouard, vice-president in charge of Google's enterprise group. "We're giving people choices." Still, his 300-person group's very existence—plus Microsoft's stated aim to extend its Office franchise to the Web—suggests that before long

these two titans of tech will be battling over many of the same corporate customers.

Google's game is clearly different from Microsoft's. Its new thrust represents a dawning era in corporate computing: software delivered as a service over the Internet, so it's accessible anywhere there is a Web browser handy. This time consumers are leading the way as they flock to Web-based applications such as e-mail, chat, and phone services like eBay Inc.'s Skype Technologies. Says Kyle McNabb, an analyst at market watcher Forrester Research Inc., "Employees may ask, 'Why can't I get the services that I have at home?'"

As traditional corporate software has grown complex and expensive to maintain, Web services are getting more capable and reliable every year. "For the first time, consumer-grade applications are good enough that they can be used by enterprises," says Douglas Merrill, Google vice-president for engineering.

It's testament to Google's popularity that even though Google Apps is still in trial mode, hundreds of thousands of users at thousands of organizations are already using it. That includes a few big ones. Arizona State University plans to switch most of its 65,000 students to

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HONDA
The Power of Dreams

Gmail, Google Calendar, and a customized "start page" this month.

But enterprise software, even if it's delivered online, is an entirely different business from that lucrative little search box. Corporate users, accustomed to feature-rich applications from the likes of Microsoft and IBM, are more demanding than consumers. Google got a taste last October when it switched over most of its own employees, who mainly had used Microsoft Outlook e-mail and Oracle Corp.'s calendar program, to Gmail and Google Calendar. Some features on the old systems that Googlers considered crucial—such as a way to schedule all those company-paid massages—weren't available on the new system. In all, employees shot back more than 1,000 requests for new features in the first two weeks after the changeover.

Microsoft figures its business experience will give it an edge

More traditional companies, with a desire for more control, will be tougher to crack. "Google Apps may hit a wall with Exxon or Bank of America," says Peter Rip, general partner with Crosslink Capital and an investor in corporate Web software firms.

Also, competitors aren't standing still—least of all Microsoft. It recently debuted Office Live, which offers Web-based e-mail, calendar, and other services in packages ranging from free to \$39.95 a month for a single business. Some 250,000 small businesses use it, compared with tens of thousands using Google Apps, by Google's estimate. Chris Capossela, corporate vice-president for Office marketing, says Microsoft has years of experience catering to businesses, unlike Google and other consumer-oriented services.

Dozens of startups, some of which Google has already bought, also have piled into the nascent market for online office-productivity software. Zimbra Inc. boasts more than 6 million e-mail boxes at 1,300 paying customers. But even those outfits acknowledge that Google's entry changes the game. Zimbra Chief Executive Satish Dharmaraj says, in the measured tones of a man who one day might find himself sitting at a Googleplex negotiating table: "They have the brains, the chops, and the cash to pull it off." ■

Bigger Bucks for The Blogosphere

Web visionary John Battelle aims to act as middleman to Mad Ave.

BY SPENCER E. ANTE

OVER THE PAST DECADE, John Battelle has shown a flair for creating innovative media properties. In the 1990s, he helped found *Wired* magazine. During the dot-com boom, he launched *The Industry Standard*. And in late 2005, he published a book on Internet search technology just as Google Inc. blasted into the stratosphere.

Now, Battelle is at the forefront of a movement attempting to answer one of the Web's most vexing questions: How

the rest to the site's owner. "It's kind of like a music label, except we don't control their intellectual property and tell them what to sing," says Battelle.

Federated Media represents just a drop in the advertising ocean. But the venture is off to a promising start. Last year, it sold more than \$10 million in advertising for about 90 Web sites. This year, Battelle says it is on track to turn profit and increase sales fivefold.

On Feb. 5, Federated got a boost by announcing it had signed as advertiser Cisco Systems, Nissan, and Nike, and 20 new sites, including video blog Rocketboom. It also resigned Boing Boing, Digg.com and a few other larger sites to long-term contracts. "It's a very compelling idea," says Dain Middleton, director of interactive marketing for Hewlett-Packard's imaging and printing group, which is working on an online campaign aimed at graphic artists. "You are able to enter a community of bloggers in a unique way."

Battelle's biggest challenge may be managing growth. Last year some site grumbled that too much of their ad inventory went unsold as Federated Media focused on signing new properties. Jason Calacanis, the former owner of Web Logs Inc., a blogging network bought by AOL in 2005, says the big limitation is that Federated Media doesn't own the sites: "The second you build your client business past \$500,000 a year, they hit their own sales force."

Battelle believes the relationships he is building with advertisers will help clear that hurdle. "Boing Boing is never going to get into the offices of General Motors," he says. "But Federated Media does all the time." ■



do you turn blogging into a day job? Millions of people publish blogs and other niche Web sites, but they struggle to make a living from their passion.

Battelle thinks his new company, Federated Media Publishing Inc., can be part of the solution. The Sausalito (Calif.) startup is signing up hundreds of the best sites and selling their ad space to brand-name advertisers such as IBM, Absolut, and Hewlett-Packard. Federated Media doesn't own the blogs, as do other blogging networks such as Gawker.com, but it keeps 40% of the ad revenue and gives

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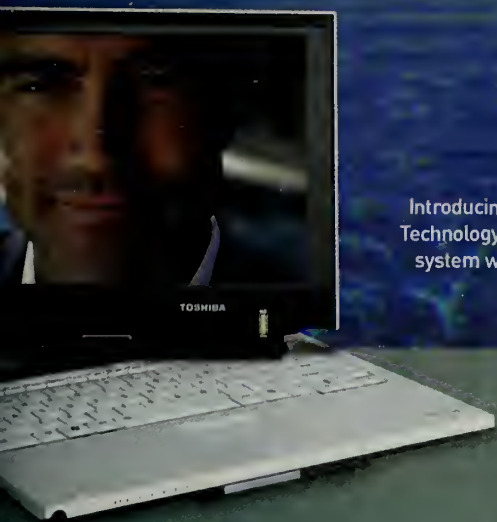
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ARMed and Dangerous?

FirstFed's portfolio of risky mortgages has the short-sellers pouncing

BY MARA DER HOVANESIAN

FIRSTFED FINANCIAL Corp. may be the riskiest mortgage lender around, but investors don't seem to mind. The stock of the tiny Santa Monica (Calif.) bank has soared more than 30% since September.

Why the feeding frenzy? Some are betting the housing market is poised for a recovery. There's also speculation that FirstFed is a takeover target, given that Wall Street has spent \$3 billion on specialty lenders in the past year. Others say the stock is too cheap to pass up. At 68, FirstFed trades at just 8.5 times 2007 earnings, compared with 18 times for bigger banks. "You either take your chances on small caps or go with an incredibly expensive traditional bank that probably has more mortgage risk than you bargained for," says Joseph Pappo, a senior portfolio manager at Lotsoff Capital Management in Chicago.

The fervor over FirstFed isn't based on what's happening in the business. In the fourth quarter, mortgage originations plummeted by 66.8%, to \$365 million—one of the steepest declines among all lenders. Cash from operating activities dropped into the red in the third quarter (the most recent data available), falling from \$49 million in 2005 to negative \$77.1 million a year later. Meanwhile, the number of problem loans more than quadrupled last year.

FirstFed's foundation could crack even further. The biggest problem: Its mort-

gage portfolio is packed with risky loans known as option ARMs. These adjustable-rate mortgages allow borrowers to make smaller monthly payments than they would normally owe by deferring the principal and adding the difference back to the balance. That may make a house more affordable at first. But when the balance hits a certain level, payments often jump significantly, and borrowers can run into major financial trouble.

FirstFed potentially faces darker days than peers who play in the same niche. For one thing, all of FirstFed's mortgages are for homes

in California, where prices have cratered and foreclosures have skyrocketed. Also, 80% of its loans have little or no documentation to prove the borrower's income or assets, according to a 100-page company presentation. The bank uses credit scores to screen for eligible borrowers.

But skeptics are starting to question the quality of FirstFed's earnings. The bulk of FirstFed's income is derived from noncash earnings, largely from the deferred principal on its option ARMs. The so-called negative amortization constituted \$223.9 million, or 68.4%, of the bank's income before taxes in 2006 compared with 1.3% in 2004. In essence,

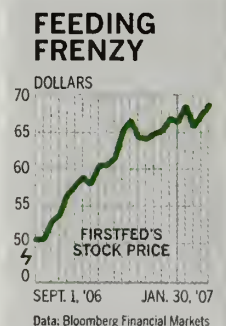
FirstFed is booking profits on money it hasn't collected. The fear is that the bank will never collect, given the high delinquency and foreclosure rates in California. Says Frederick Cannon, managing director at Keefe, Bruyette & Woods Inc., "The bearish view is that all the earnings are coming from money they didn't get yet."

RED FLAGS

FIRSTFED ADMITS the environment is tougher today, but says its borrowers have stellar credit and can afford to keep up with the option ARMs' rising payments. Indeed, FirstFed's loan portfolio, with a higher credit quality and lower delinquency rate, is holding up better than those of larger competitors such as Countrywide Financial in California, basas, Calif., and Washington Mutual in Seattle. FirstFed CFO Douglas J. Goddard says the bank fully expects to collect on its loans. "In our near 25 years of offering this product, we have yet to find where 'payment shock' caused a default," he explains.

Still, given all the red flags, it's no wonder short-sellers have pounced. Since 40% of the company's 15.3 million shares have been sold short. That dynamic may have helped boost the stock. As it climbed, hedge funds and others rush to buy more shares to cover their money-losing short position, pushing the stock higher.

And as it goes up, the stock is attracting new buyers. "I constantly see momentum players buy financial companies because they hit some screen, but they don't really know what they own," says Richard Eckert, senior research analyst at ROT Capital Partners in Newport Beach, Calif. "They are not distinguishing between cheap, and cheap for a reason." ■



Green Homes: The Price Still Isn't Right

Buyers are declining environmentally friendly features. That may change

BY CHRISTOPHER PALMERI

ONCE THE PROVINCE of custom homebuilders and small niche players, green building is catching on with the giants of the home-construction industry. The percentage of new homes built with eco-friendly features will rise from 2% in 2005 to as much as 10% by 2010, according to a study by the National Association of Home Builders and McGraw-Hill Construction (which, like *BusinessWeek*, is a division of the McGraw-Hill Companies).

But the folks who buy lumber by the trainload still find it a lot easier to persuade home buyers to upgrade to granite pountertops than pay for an energy-efficient furnace. That puts builders in a bind as their industry suffers through a serious slowdown. "We're trying to understand the balance between our social obligations and our obligation to shareholders," says Jeffrey T. Mezger, CEO of KB Home, one of the nation's largest homebuilders. "You can't just give away our margin."

Mezger, 51, the son of a Chicago-area

homebuilder, got a glimpse of green economics when KB opened a subdivision in the Northern California town of Pleasanton three years ago. It used wood harvested in an environmentally friendly manner, according to guidelines from the Forest Stewardship Council. Although that added just \$3,500 to the cost of a \$700,000 home, Mezger says KB couldn't get a premium for it. Last year just 47 of KB's 25,000 home buyers chose environmentally benign bamboo for flooring. Offered front-loading washing machines from Whirlpool that use 60% less water and electricity than top loaders, only 3% of customers accepted. A Whirlpool spokesperson says buyers generally don't purchase washing machines from builders.

EVOLVING CODES

IN THE CASE OF SOLAR panels, buyers are clearly put off by higher up-front costs. McStain Neighborhoods in Louisville, Colo., bills itself as the state's premier builder of green homes, selling more than 300 a year. It offers solar panels as a \$25,000 option on homes rang-

ing from \$300,000 to \$500,000—but they're a tough sell, even though they can pay for themselves in a matter of years. In six years it has installed solar kits on just three houses. The Solar Energy Industry Assn., a trade group, says the number of homeowners installing solar-electric panels nationwide jumped 75% last year, to 8,512. But that's still a sliver of the 1 million new homes sold in the U.S. in 2006.

Change may be coming: New federal and state subsidies could cut the cost of solar panels in half. As a result, McStain is making photovoltaic panels standard in all 42 homes it's building at a new subdivision in the Denver suburb of

Westminster. And local building codes are getting greener, forcing builders to include environmentally friendly features. Companies that sell to the construction sector have gotten the message. Major homebuilders can now purchase

an array of green products in volumes and at prices that make them cost-competitive. Suppliers include carpet maker Shaw Industries, building-products supplier Louisiana-Pacific, and Masco Industries, which makes cabinets, plumbing, and insulation. Their efforts have helped drive energy use in new homes down 30% per square foot since 1970.

Some homebuilders are making even high-cost green features standard as a way to help their models stand out in a tough market. Clarum Homes in Palo Alto, Calif., includes satellite-controlled sprinkler systems that conserve water and decking made of recycled materials in all its homes. Founder John Suppes says these add about \$22,000 to the cost of a \$700,000 home.

KB's Mezger concedes that the industry has to do a better sales job. He says he has been inspired by the yellow stickers the Federal Trade Commission requires on appliances that detail how much energy they use and how much they cost to operate over time. In March, KB plans to introduce a marketing initiative called "myEarth" at each of its 30 design studios. When home buyers select options such as appliances and light fixtures, they'll see pitches on products such as tankless water heaters, which save energy by heating water as needed instead of storing it. ■



SOLAR PANELS
New subsidies
are on the way

BusinessWeek weekend

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PETER DASILVA/THE NEW YORK TIMES/REDUX

Hipster Appeal, Mall Prices

In a bid to be No. 1 globally, Japan's top retailer opens a flagship Uniqlo store in Manhattan



BY ELIZABETH WOYKE

THE NOVEMBER UNVEILING of Uniqlo's new global flagship store was audacious, even to the jaded habitués of Manhattan's SoHo. At 36,000 square feet, it's the area's second-largest retail showroom (after Bloomingdale's), dominating a block packed with rivals like H&M and Banana Republic. The cool Japanese retailer tried to build buzz by blanketing the city with ads featuring offbeat celebrities like Sonic Youth guitarist Kim Gordon. It worked: Holiday crowds flocked to the slick emporium that seemed to have popped out of nowhere.

The SoHo flagship is, in fact, just the latest outpost in a vast empire. Founded in Hiroshima in 1984 by Chairman and Chief Executive Tadashi Yanai, Uniqlo is Japan's largest casual apparel retailer, with 733 outlets in Asia, Britain, and the U.S. The retailer quietly ventured into the U.S. market in late 2005 with three small New Jer-

sey stores. It's been an expensive gamble. Uniqlo forecasts a \$6.5 million operating loss on sales of \$28 million in the U.S. for 2006-2007. Its worldwide operations make up roughly 90% of parent company Fast Retailing Co.'s business; Fast Retailing expects to earn about \$338 million on sales of \$4.4 billion. Uniqlo predicts a profit in the U.S. in its next fiscal year, and its long-term goals are more ambitious: \$1 billion in U.S. sales by 2011 and, eventually, bragging rights as the No. 1 clothing retailer globally. To succeed in an increasingly commoditized market, say analysts, it must keep innovating while striking a balance between being hip and having broad appeal.

GODZILLA FILMS

PROFITS HAVE been elusive, but observers have been impressed with Uniqlo's deft, confident U.S. foray. The chain aims to sell J. Crew quality at Gap prices, says Uniqlo USA CEO Nobuo Domae. All three retailers offer casual, well-priced

basics for all ages. But Uniqlo, whose name comes from the words "unique clothing," takes a slightly more fashionable approach in its merchandising and store design. "Before, our image was clean, organized, and simple," says Domae. "To compete globally, we realized we needed to add more fashion." The result is trendy items such as line vests and brightly checked poplin shirts for men and ruched, sleeveless dresses and peasant-neck blouses for women. "A lot of brands have gone middle-of-the-road. Uniqlo is a little more exciting," says Schatzi Page, a 37-year-old artist.

The presentation is cosmopolitan and urban, so it's no wonder Manhattanites are drawn to it. Uniqlo's broader appeal, however, may lie with its prices. Nothing in the flagship costs more than \$140, with most items, including cashmere sweaters, in the \$40-to-\$70 range. (At Gap, similar items cost between \$50 and \$100.) Uniqlo says it keeps costs down by tightly controlling the design, manufacture, and distribution of its clothes—getting discounts on cashmere by placing orders during the end-of-year "low season," for instance.

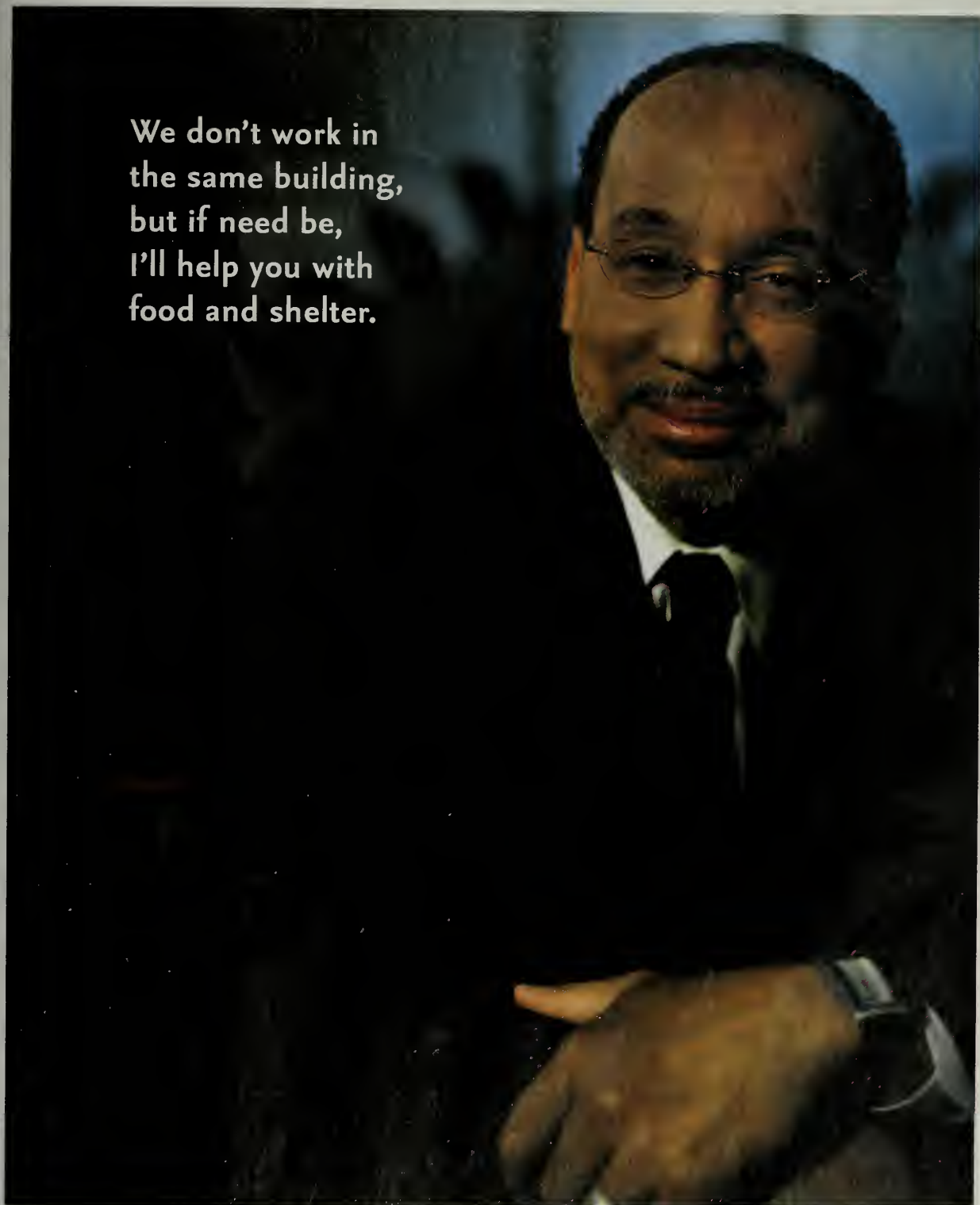
The flagship's design reflects the chain's brand philosophy, a kind of

HEY, GOOD-LOOKIN' The SoHo glass "aquarium" features revolving, Uniqlo-clad mannequins

of no-fuss individualism. It also helps sell clothing. A glass "aquarium" with revolving, Uniqlo-clad mannequins dominates the front of the space. A three-story staircase, on which customers can sit, mingle, and ogle each other, anchors the back. Surrounding these dramatic focal points is a spare interior of white walls and glass tables, designed to direct attention to the products themselves. The space feels stylish and airy, despite being stuffed with floor-to-ceiling shelves.

The design has other benefits. Mike Bills, a managing partner at retail design firm Fitch, says the clean canvas lets people project whatever they like onto the brand, similar to Apple Inc.'s use of white space in its shops and ads. At the same time, decorative elements, including a wall of TVs showing a Godzilla film, augment Uniqlo's image as a fun Japanese company. "It feels like a lifestyle experience," says retail expert Dana Telsey of New York's Telsey Advisory Group, "which is what a brand should be." ■

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My Year at Wal-Mart

How marketing whiz Julie Roehm suffered a spectacular fall in 10 short months

BY ROBERT BERNER

JULIE ROEHM GOT A CALL from her boss's assistant at 12:15 p.m. on Dec. 4. J. John Fleming, then chief of Wal-Mart Stores Inc.'s marketing department, wanted a word with his senior vice-president. Walking to Fleming's office at the Bentonville (Ark.) headquarters, Roehm recalls thinking she was about to be fired. She was right. Ten months after being recruited to help modernize Wal-Mart's tired brand, Roehm was out.

The meeting lasted seven minutes, Roehm says. A "very nice" human resources manager collected her company badge, Palm Treo, corporate credit card, and, yes, Wal-Mart discount card. Then the HR representative escorted Roehm out a side door to the parking lot. Standing there in the sunshine, she recalls asking herself: "How do I feel about all this?" I sort of felt relieved.

It isn't often that the dismissal of a midlevel executive makes national news. But Julie Roehm is no ordinary executive. Before joining Wal-Mart, Roehm, 36, earned an edgy reputation as director of marketing communications at Chrysler Group. There she famously agreed to sponsor an alternative half-time Super Bowl show. It was jokingly called the Lingerie Bowl and featured scantily clad models. After protests, Chrysler backed away. Given her colorful career, Roehm's hiring by one of America's most colorless companies always struck friends and industry insiders as odd. And few were

surprised when Roehm and Wal-Mart parted ways.

But the dismissal ignited controversy. For several weeks, press reports circulated that Roehm was fired for accepting gifts and gratuities from ad agencies she was doing business with and because she carried on a personal relationship with a subordinate. Roehm and the man in question, Sean Womack, who was fired shortly after she was, deny both allegations. Now, for the first time, Wal-Mart says it has "irrefutable evidence that the relationship involved specific instances of inappropriate personal conduct." What's more, spokesperson Mona Williams told *BusinessWeek*: "Wal-Mart is prepared to prove that this misconduct did in fact occur."

WARRING FIEFDOMS?

ON DEC. 15, Roehm filed suit against her former employer, alleging breach of contract, fraud, and misrepresentation. Roehm seeks payment of more than \$1.5 million, to cover severance pay, stock options, restricted stock, and bonus. But in its response to Roehm's suit, the company argues that under the employment contract, it is not liable for such payments if the plaintiff is "terminated as the result of a violation of Wal-Mart policy."

Now, in her first lengthy interview since filing suit, Roehm gives *BusinessWeek* her side of the story. As Roehm tells it, hers is a cautionary tale of what happens when a self-described change

FILING SUIT Roehm alleges breach of contract, fraud, and misrepresentation





agent goes to work for a company that needs to reinvent itself but can't. In Wal-Mart's case, she says, the concept of "Everyday Low Prices" was so deeply embedded that the retailer's ambition of getting upscale shoppers to buy more was a non-starter. Roehm acknowledges mistakes, among them moving too quickly and not adapting to her new workplace. But she also paints a picture of warring fiefdoms and a passive-aggressive culture that was hostile to outsiders. Wal-Mart, she says "would rather have had a painkiller [than] taken the vitamin of change." What has she learned? "The importance of culture. It can't be underestimated."

When Wal-Mart came knocking, Roehm had been working at Chrysler

“

[Wal-Mart]
would rather
have had a
painkiller [than]
taken the vitamin
of change.”

—Julie Roehm

for nearly five years. It was a company that all sides agree fit her temperament perfectly. "We're probably the edgiest automaker in terms of the things we try. And the times Julie went over the edge have been well documented," says Jason Vines, the automaker's chief spokesman. "But we realized you don't know where the edge is unless you are willing to go over it once in a while."

Roehm was flattered when headhunter Spencer Stuart contacted her in September of 2005 about possibly joining Wal-Mart. She saw an opportunity to head a

until she sold it, and Roehm's compensation wasn't half bad: a base salary of \$325,000, a signing bonus of \$250,000, plus restricted stock of about \$300,000, stock options valued at approximately \$500,000, and an annual performance bonus of up to \$400,000.

Still, Roehm recalls friends looking at her "like I was crazy" for taking the job. And from the moment she arrived at Wal-Mart on Feb. 6, 2006, Roehm recognized that fitting in would be harder than she had imagined. This wasn't Chrysler. And the Wal-Mart headquarters, with its

was "super nice" and said things like "thanks for participating," Roehm heard from her own staff that "you shouldn't do" things like planning skits for the annual meeting.

But Roehm says Fleming, who was not made available to comment, seemed dedicated to doing whatever it took to update Wal-Mart's image. And that included turning the marketing department into a real power center, after years of deferring to merchandising, which had always determined what went on store shelves. "He called us 'a startup in the world



marketing communications department and be part of a potentially exciting effort to transform the company and its image. By then Wal-Mart was struggling. Earnings growth had stumbled the previous year on continued weak sales growth, and the stock price remained below its 1999 levels. For the first time, a company that for decades had religiously followed Sam Walton's low-price edict suddenly seemed ready to take a different tack.

Roehm and her husband, Michael, who looks after their two boys, age 5 and 8, wondered about moving from suburban Detroit to Bentonville. The pace was going to be a lot slower in Arkansas. In the end, opportunity nixed the negatives. Wal-Mart was promising to continue paying the mortgage on the Detroit home

windowless offices and gray walls, was hardly inspiring for a woman unafraid of a little color. One of the first things Roehm did was paint her office chartreuse with chocolate-brown trim. That may have been her first mistake—and it's revealing that Wal-Mart, in its response to Roehm's suit, says she is free to collect "a step ladder and paint supplies" left behind after she was dismissed.

Some new hires would keep a low profile and spend their first 100 days listening. That's not Roehm's style. "I get overly excited," she acknowledges. "I wanted to hit the ground running. Go, go, go." No one told her to back off; that's not the Wal-Mart way. Even though everyone

STAYING THE COURSE
Wal-Mart continues to push its low prices over everything else

largest turnaround," Roehm recalls.

Fleming had already brought in outsiders to effect change, including five marketing people from Peps-

Co Inc.'s Frito-Lay division. They were known as the Frito Five. One was Stephen Quinn, who was charged with building consumer research and marketing strategy department and reported directly to Fleming. His job was to identify key consumer trends that would help guide the merchants and help determine how the retailer should position itself.

Roehm was Quinn's counterpart. A chief of marketing communications, she was in charge of consumer advertising. And, most important of all

The Right Way To Shake Up a Company

I'm all for progress. It's change I object to." Mark Twain, to whom that quote is usually attributed, may not have ever uttered or written those words. But whoever did could have made a fortune coaching managers on that most necessary, often mishandled responsibility: introducing new ideas to employees who don't necessarily want to give up the old ones. Virtually every company has people, maybe huge numbers of them, who will resist change until the bitter end. It's human nature.

All this suggests that the *agents provocateurs* could make life a whole lot easier for themselves by remembering what Louis V. Gerstner Jr., the former head of IBM and a master of change, once really did write: "Culture isn't just one aspect of the game—it is the game."

Here, then, are a few words of wisdom from the experts for all those change agents out there.

» There's nothing wrong with being humble.

"Effective change agents don't go around shouting about it," says Dev Patnaik, managing associate of Jump Associates. "The smarter ones don't want to seem interesting, but interested." That's especially true if someone is brought into a company to transform some part of it, but it also makes sense for a manager who has been promoted or given a new assignment that is likely to disturb the ecosystem. As Miriam Javitch, director for global organizational change at YSC, a management consulting firm, says: "Understand and honor the DNA of the organization. The system will reject you otherwise."

» Pay attention to the informal networks.

It's not enough to win the support of the leaders high up in the hierarchy (although without the backing of the chief executive, the chances of failure are pretty good). You also have to convince the opinion leaders—those who influence employees in ways no organizational chart will reveal. "If an individual simply invokes the name of the CEO to ask for change, they're doomed," says Janice A. Klein, a senior lecturer at Massachusetts Institute of

« Effective change agents don't go around shouting about it

Technology's Sloan School of Management. "You have to build a network and a case for change."

» Determine a company's tolerance for change.

In some cases, if you move too quickly, you'll lose credibility; in others, if you wait too long, you've lost your

chance. For outsiders in particular, it's important to suss out a few people who can be informal advisers—cultural interpreters, if you will. "Listen to them to understand any symbolic faux pas," says Jane M. Stevenson, a global managing partner at recruiters Heidrick & Struggles International.

» An early success can do wonders.

When you are pushing for a fundamental transformation of a company, don't try to do everything right away. "Have a big dream, but don't do a lot at once," says Vijay Govindarajan, a professor at Dartmouth's Tuck School of Business. Taking a small step first gives you credibility, contains the risk, and, even if you make a mistake, gives everyone the opportunity to learn. Companies and people, he says, have a finite capacity for change. ■

—By Susan Berfield

Roehm was to recruit a new ad agency. Roehm says there was trouble from the start. She says Quinn, who was not available for comment, wouldn't invite her to strategy meetings or return her phone calls. This made it harder to refine her marketing message, Roehm says, adding: "I thought we'd work smarter thinking as a team." Fleming, she says, told her to build bridges with Quinn. But Roehm says she believes that the real problem was that Fleming hadn't clearly defined their roles. She felt her role as being minimized to merely handing off Quinn's market research to the ad agencies. Spokesperson Williams says Roehm's "statements about her working relationship with John Fleming and Stephen Quinn are false." By her third month on the job, Roehm had the sense that Fleming was not going to intervene in her behalf.

THWARTED EFFORTS

STILL, SHE WAS TOO busy to fret. For much of the summer, Roehm jetted around the country visiting the 30 or so ad agencies that were bidding to win the \$580 million Wal-Mart account. It was during these weeks and months of nonstop travel that Roehm, looking back, realizes she could have played her politics more astutely. Every Friday morning, Chief Executive Lee Scott gathers together 100 managers and executives for an all-purpose meeting in an auditorium at Wal-Mart's headquarters. Roehm, on the road and unaware of how important it was to attend these meetings, missed several in a row. "Had I known," Roehm says, "I never would have been gone on Friday."

Back in Bentonville, the merchandisers were thwarting marketing's efforts to appeal more to upscale shoppers. According to Roehm, the merchants didn't want to take cues on consumer trends from Quinn's team. Roehm says this became abundantly apparent during the back-to-school season when Quinn's people tried and failed to get the merchandisers to push denim, one of the hottest trends in apparel, in the stores. And even as Fleming pushed to upgrade and unclutter store interiors, the merchants pushed for more in-store signage to telegraph that Wal-Mart was still all about low prices.

By the end of summer, the merchants were winning the war. As Wal-Mart's same-store sales continued to slide, Roehm says, Wal-Mart decided to refocus on low prices. More price signs began appearing in stores, and price again became the dominant theme in advertising. "I spent so much time on

People | Ousters



Corner Office



signs in the stores, it was mind-boggling," Roehm says. She recalls a sign for Metro7, one of Wal-Mart's snazzier women's brands. It showed a woman in a black dress walking down a dark street and blared: "Wow Now Pricing." "It looked like she was for sale," says Roehm. "She looked like a hooker."

FLEETING TRIUMPHS

AS FALL APPROACHED, the deadline for the agency review was looming. On Oct. 15, Wal-Mart finally settled on one of Roehm's top picks, DraftFCB. At the time, both Roehm and agency chief Howard Draft were unaware that someone at his firm had placed an advertisement in an industry publication, celebrating the clinching of several awards. The ad featured a lion mounting its mate with the tag line: "It's good to be on top." Not surprisingly, the ad did not go over well inside Wal-Mart. Roehm thought: "Oh my God. This is the last thing we need." (Wal-Mart would ditch the agency three days after firing Roehm.)

Even small triumphs were turning to ashes. Roehm had helped conceive a TV ad for the Christmas shopping season. It featured a middle-age couple opening presents. The woman, sitting on the husband's lap, opens a box to reveal a red silk nightgown. With his teenage kids and in-laws looking on, the man grins happily. His wife loves the gown. And Wal-Mart, says Roehm, loved the ad. At first, anyway. Then, she says, the company got word of a complaint from a consumer who saw the ad while watching *Desperate Housewives*; shortly after, the ad was pulled. Roehm couldn't believe it. "With a company as big as that," she says, "you are never going to satisfy 100% of the people."

The beginning of the end arrived on Nov. 30. Roehm was in Chicago for meetings with Draft. While at the agency, she received a message that Eduardo Castro-Wright, Wal-Mart's U.S. president, was dispatching a corporate jet to pick her up. "Eduardo wanted to meet with me," she says. "That's all the message said."

An ice storm was raging in Bentonville when she landed early that evening, shutting down most of the city. She drove to the Wal-Mart headquarters and met Fleming and Castro-Wright in



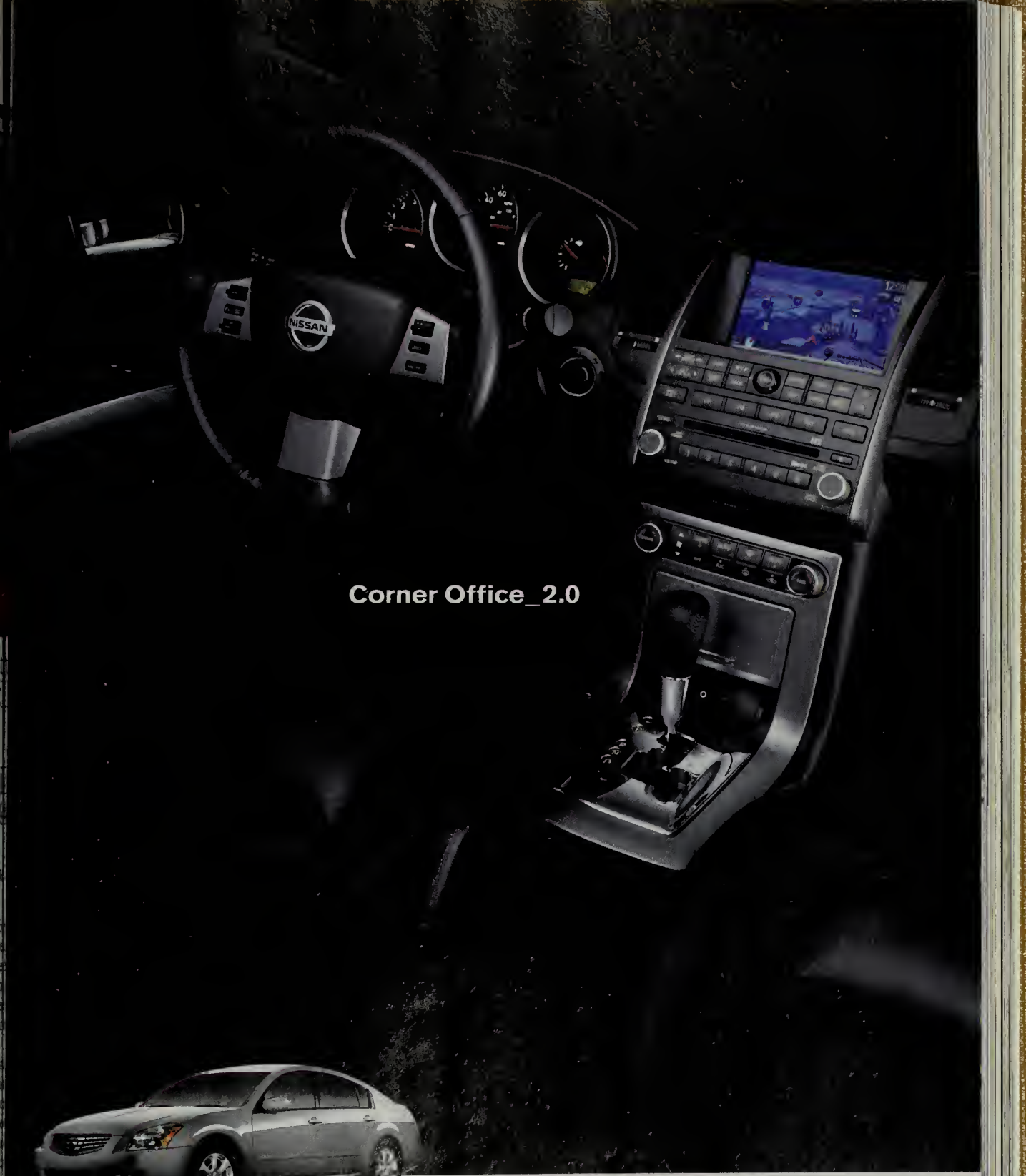
“The times Julie went over the [marketing] edge have been well documented. But you don't know where the [marketing] edge is unless you are willing to go over it once in a while.”

—Chrysler chief spokesman Jason Vin

the latter's office. Roehm says they began grilling her about the agency review process, how Draft had been chosen and who inside the company had voted for it. Roehm says she detected no agenda or sense that they were questioning her judgment.

But when the meeting ended 45 minutes later, she was ushered into another room with an internal security person and someone from legal. They asked if she was having an affair with a subordinate but drilled down most questions of accepting gratuities as gifts during the agency review process. "It was surreal," Roehm recalls. "It was like good cop, bad cop. They were asking crazy questions and I was thinking 'What is this?' I had never been through anything like that before." Four days later, Julie Roehm's Wal-Mart career was over. ■

—With David K



Corner Office_2.0



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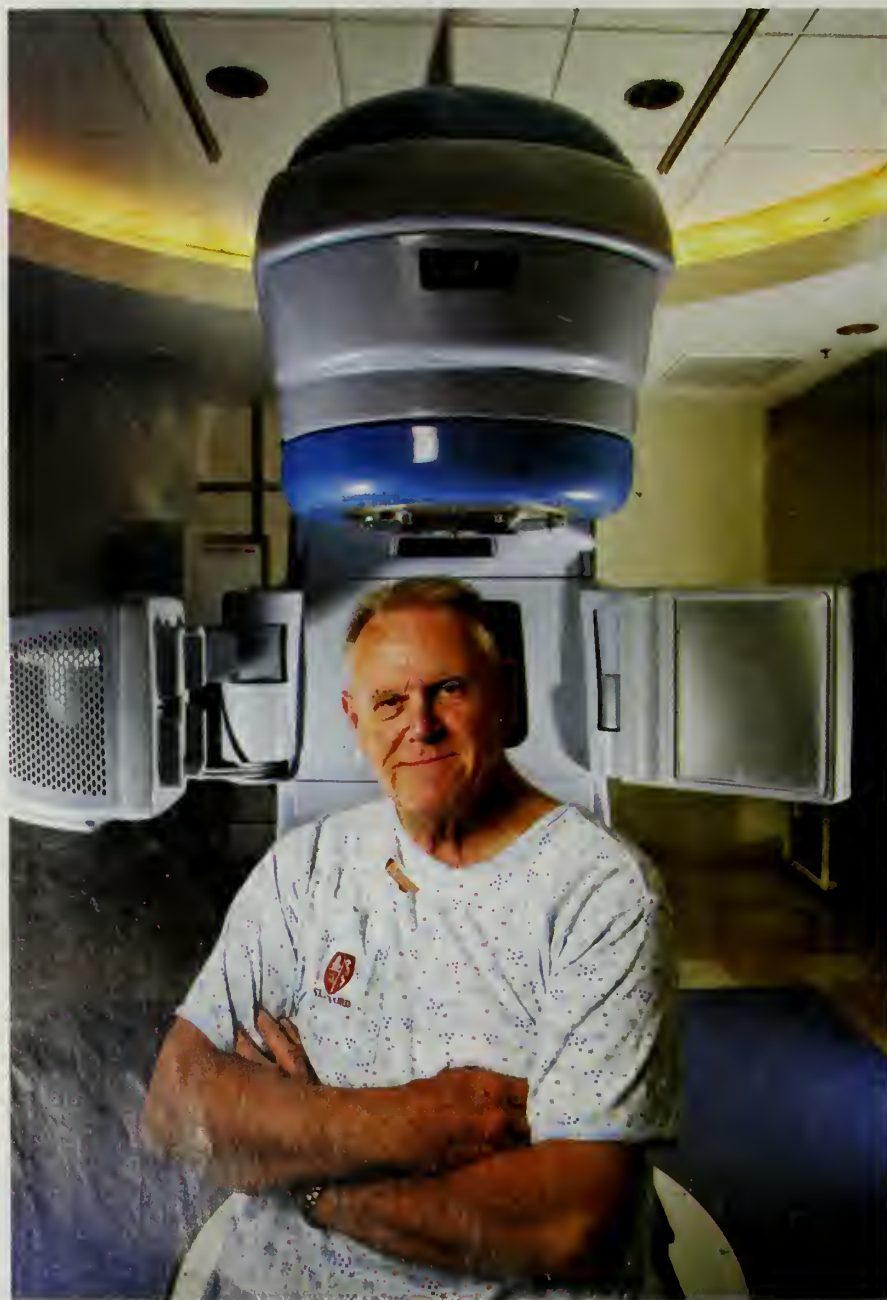


SHIFT_2.0

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Precision-Guided Cancer Weapons

Innovations in radiation therapy are reducing 'collateral damage' and saving lives



BY PETER BURROWS
AND NICHOLA SAMINATHER

IN EARLY 2005, PHIL OGDEN noticed he was having trouble swallowing food and went to a doctor, thinking he might have acid reflux. The news was far worse. The 60-year-old retired cop from Modesto, Calif., had esophageal cancer, and it had already spread to nearby lymph nodes. Dr. Albert Koong, a radiation oncologist with Stanford University's Comprehensive Cancer Center, asked if Ogden would mind being the first person to undergo a new type of radiation treatment. "The doctor said: 'For the first time in history, we can bomb the equivalent of a outhouse from 30,000 feet with no collateral damage,'" Ogden recalls.

Koong was referring to treatment with a \$3 million device from Varian Medical Systems Inc. It combines a linear accelerator, which emits high-energy X-ray beams, with advanced imaging gear. The machine enabled the doctor and his team to home in on cancerous cells and deliver precise doses of radiation over a six-week period without harming surrounding tissue. For the patient, that meant fewer side effects of radiation, such as a dry mouth and weight loss. Within days, Ogden was putting on pounds as it became easier to swallow. Ogden has since had to receive chemotherapy to treat small spots of cancer elsewhere in his body, but his esophagus remains cancer free.

**INNOVATION
CASE
STUDY**

A CHEAPER ALTERNATIVE

THANKS TO A STREAM of innovation, the century-old medical technology known as radiation therapy is starting to play a more prominent role in treating many kinds of cancers, including cases in which the tumors have begun to metastasize to other parts of the body. "We used to consider metastatic cancer incurable, so what was the point of taking aggressive treatment that would lower the quality of the remainder of the person's life?" says Dr. Yoshiya Yamada, a radiation oncologist at Memorial Sloan-Kettering Cancer Center in New York. But improved radiation therapies are dramatically changing that equation, he says.

ON TARGET

Ogden's treatment resulted in far fewer side effects

"We're giving options to people that had no options."

Radiation, often in combination with other types

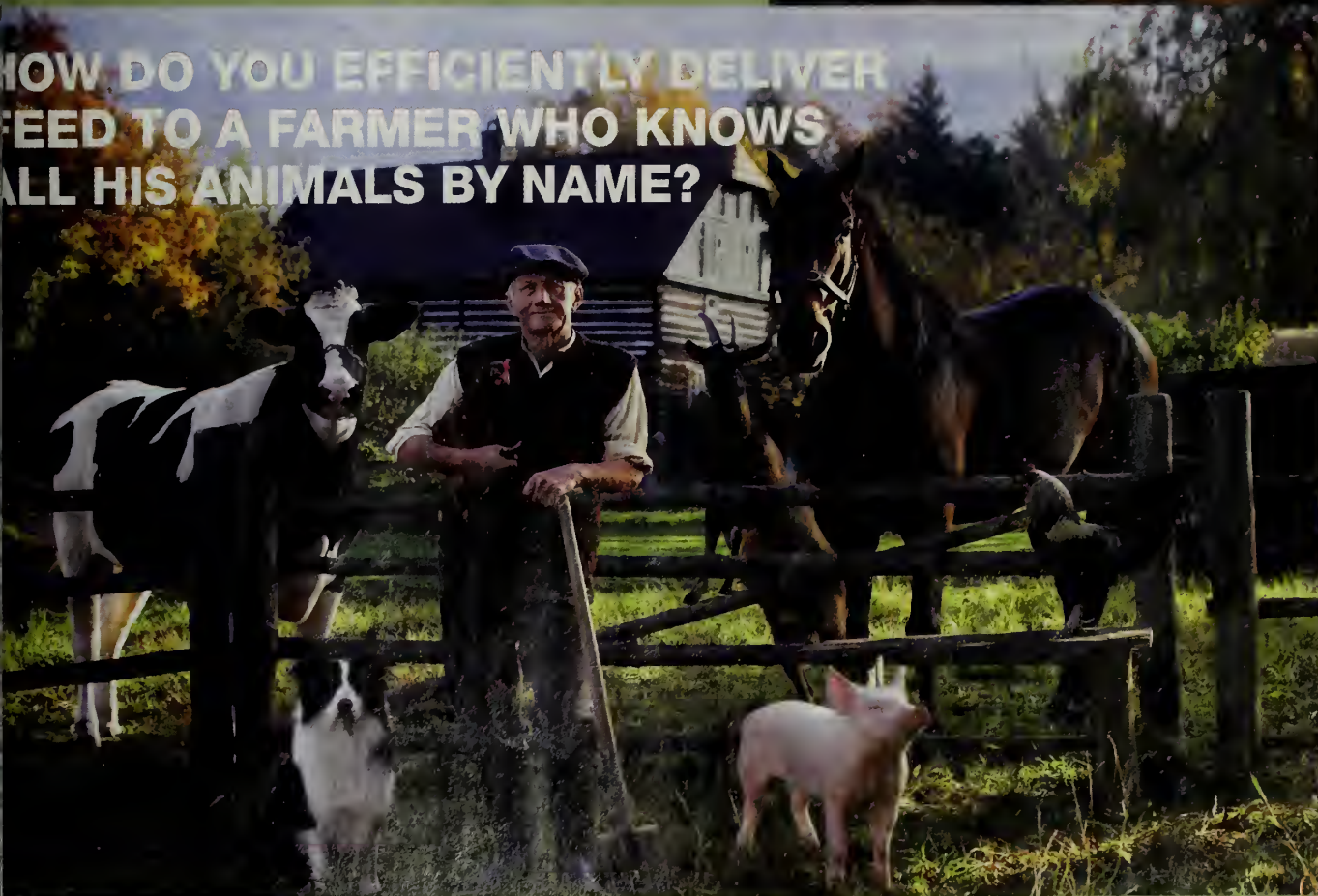


Conventional wisdom would tell you small farms can't operate as efficiently as large ones. But in Poland, Cargill is going beyond the conventional to help small livestock farmers compete. Large farms in Europe have traditionally had the advantage of feed delivery services while small producers must travel to dealers to buy the few bags they require. So Cargill worked with feed dealers to bring the store to the farm, on trucks that efficiently deliver small feed orders on a regular schedule. The dealers get new customers and farmers get service they never thought possible. This is how Cargill works with customers.

collaborate > create > succeed™



**HOW DO YOU EFFICIENTLY DELIVER
FEED TO A FARMER WHO KNOWS
ALL HIS ANIMALS BY NAME?**



Health | Cutting-Edge Care

treatment, is now used to treat 70% of diagnosed cancers, according to the American Society for Therapeutic Radiology & Oncology. And with a typical 40-session regimen costing under \$20,000, it can be a relatively cheap alternative to the latest drug therapies, which cost \$40,000 a year or more for a single medication. In the future, some patients may be able to go into the hospital for a yearly radiation treatment to kill off any newly appearing cancer cells, thus turning a once-fatal disease into a chronic condition. Varian Chairman Richard M. Levy believes improvements in radiation therapy are largely responsible for raising the five-year survival rate for cancer patients from 40% to 65% over the past 30 years. He says that could go as high as 80% in the not-too-distant future as technology keeps improving.

With 70% market share for medical radiation gear in the U.S., Varian has come up with many of the key advances in this field—along with software and training programs that make it easier for hospitals to embrace the technology. Most of the breakthroughs involve reducing

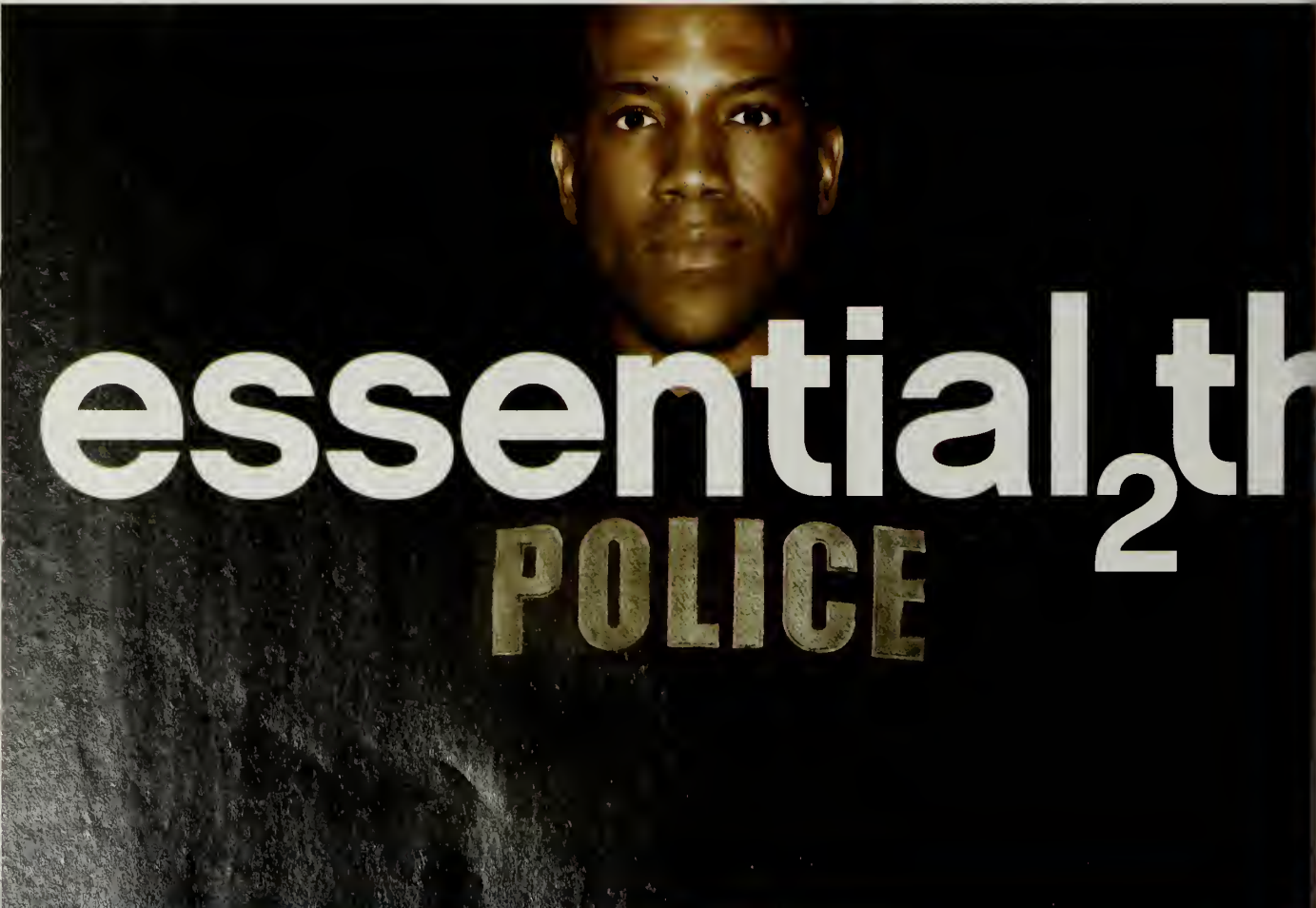
LIFESAVER Levy thinks the five-year survival rate will keep climbing



collateral damage to healthy tissue. A high-intensity beam of energy can zap almost any cancer cell it encounters. But until recently, radiation was a fairly blunt instrument, killing everything around the diseased cell and making it difficult to treat tumors deep in the body. Doctors would use X-ray imaging to get a better view of tumors, then aim thick, uniform columns of radiation where they thought the cancers might lie. Varian and other radiation-device makers changed all of this in the late 1990s with a technology called intensity-modulated radiation therapy, which allowed physicians to beam lower intensity rays from almost any angle, with each ray sculpted to conform to the shape of the tumor.

PINPOINT ACCURACY

VARIAN'S NEXT breakthrough, called image-guided radiation therapy, lets doctors monitor any shift in the position of the tumor from day to day by means of combined CT scans and PET scans, further reducing the damage to surrounding tissue. This is the treatment Philip Ogden received at Stanford. The CT scan helps doctors pinpoint the location of the cancer, and the PET scan provides detailed



essential, the POLICE 2

the tumor's size and activity. With the help of infrared imaging during the procedure, the beams can be adjusted to compensate for movement as the patient breathes. "This was all a pipe dream just a few years ago," says Sloan-Kettering's Yamada.

One powerful application of this technology is stereotactic radiosurgery, which allows massive doses of radiation to be given in a few treatments, or just one. This has been used initially for inoperable brain tumors, but the technique could be employed more broadly as doctors gather clinical evidence that it is effective and safe. "It's extraordinary to look at where we started and where we are now," says Dr. Marnee Pierer, a radiation oncologist at Montefiore Medical Center in the Bronx, N.Y. Innovation has resulted in a profitable business for Varian. In the fiscal year that ended last September, the company earned \$245 million on sales of nearly \$6 billion, and it reported net income of \$49.5 million for the latest quarter, up from \$41.2 million the year before.

Varian sold 500 linear accelerators in 2006 alone, many of them high-end models with full imaging capabilities.

Cancer centers that spring for the expensive equipment have no trouble finding patients. Memorial Sloan-Kettering says its 10 linear accelerators are fully utilized. At cancer center operator Radiation Therapy Services Inc.'s 76 locations, about 1,600 patients are treated every day. And some 120 patients receive daily care at Stanford University Hospital's cancer center.

It's true that some forms of cancer remain inaccessible to radiation treatment.

And there are limits to how much radiation the body will tolerate—especially organs such as the pancreas, the eyes, and the spinal cord. Phil Ogden hit his limits for radiation, and now relies on chemotherapy to attack spots of cancer in his neck and upper back. And skeptics would like to see more long-term data that the latest developments in radiation therapy can actually keep patients alive longer.

Recently, critics also have raised ques-

tions about the economics of radiation therapy. Insurance reimbursements to hospitals performing such treatments tend to be higher than for some other therapies. So once a hospital splurges on a radiation center, critics say there could be a risk that doctors or administrators will steer patients in that direction.

But physicians deny that treatment decisions are driven by financial concerns. For one thing, they note, Medicare and most private insurers have their own physician committees, which review diagnoses and prescribed treatments on a case-by-case basis. Dr. Charles Vialotti, radiation oncologist at Holy Name Hospital in Teaneck, N.J., points out that using the latest combined radiation and imaging techniques is "very labor-intensive. I can't imagine prescribing it when it wasn't necessary." Not that doctors lack enthusiasm for the technology. Says Todd Scarbrough, a radiation oncologist at the MIMA Cancer Center in Melbourne, Fla.: "We have this hammer, and we see many appealing nails." ■

BusinessWeek .com

RAY'S OF HOPE: For a look at next-generation radiation treatments, go to www.businessweek.com/extras.

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Super Bowl Sunday's Hail Mary Ad

Inside the making of a commercial that could be crucial as GM tries to build a new image

BY DAVID KILEY

FOR FOOTBALL FANS, THE drama will be over the second the clock runs out on Super Bowl XLI. But for General Motors Corp., the moment of truth will come the following day. That's when consumers and the media will weigh in on the latest crop of Super Bowl ads, among them GM's spot about an anthropomorphic robot. This isn't just a one-off spot: GM wants the robot to star in its ongoing effort to convince drivers it's as obsessed about quality as Toyota Motor Corp. If the \$5.2 million ad fizzles, it's back to the storyboard.

GM is understandably keen to convince Americans that, as surveys consistently show, it has substantially closed the quality gap with the Japanese. Nowhere is that perception tougher to change than in Southern California, a huge market teeming with Toyotas, Hondas, and BMWs—not Pontiacs or Chevys.

Hiring Deutsch/LA gave GM a twofold: ad executives who understand the California market but also have a long-standing link to Detroit. Chief

MY NIGHTMARE In 60 seconds, the robo-employee errs, is chided by peers, and suffers—but it's only a dream

Creative Officer Eric Hirshberg and President Mike Sheldon are both sons of former GM executives. Hirshberg's father designed the iconic

Pontiac Trans Am in the 1970s; Sheldon's was a purchasing boss. "We liked the feeling Deutsch had for GM," says GM Marketing Vice-President Mike Jackson. "Outsiders living in the land of imports who were rooting for our success."

The robot ad was originally conceived to market GM's five-year, 100,000-mile warranty, which launched in September. But GM decided the conceit was perfect for the Super Bowl. The concept springs from a desire to tell a story in the context of GM's manufacturing prowess.

The script goes like this: An assembly line robot drops a screw. The other robots and line workers glare at the klutz, who is then escorted from the factory. The robot goes on to a series of humiliating jobs: holding a real estate for-sale sign, the speaker at a fast-food drive-through, and so on. He looks wistfully at GM cars driving by—the Cadillac CTS, Pontiac Solstice, Chevy HHR. Eventually, he makes his way to a bridge and hurls himself off. But the robot isn't dead after all; he wakes up in the factory to find it was just a nightmare. The message: Everyone at GM is obsessing, even dreaming, about quality.

Even before Deutsch began making the ad, the concept set off critics. They told Jackson that selling the carmaker as a whole was doomed. "People don't buy 'GM' vehicles," says Jim Sanfilippo of Automotive Marketing Consultants Inc. "So I think the emphasis on GM as a brand is wrong." Hirshberg disagrees. Besides the stock



ROBO-KLUTZ
Sheldon,
Hirshberg,
and their star

symbol being "GM," he says, thousands of mostly negative stories appear each year with "GM" in the headline. "We need work on changing GM's story," he says. "People don't like to buy loser brands."

The sniping was bad enough; Hirshberg also knew that making a 60-second narrative resonate with viewers was going to be easy, especially against a boozy backdrop of a Super Bowl Sunday. In one minute flat, the ad needed to cross not just the story but GM's quality message, too. And for this particular concept to work, the robot had to seem sufficiently human. If viewers didn't f





apathy for the bot, the ad would fail. The commercial was shot at GM's five-year-old assembly plant in Lansing, Mich., a gray Saturday in early December. Just 100 yards away hulked the empty shell of shuttered Oldsmobile headquarters. Hirshberg couldn't escape the irony: At a place where GM's decline was writ large, they were trying to project the automaker as a 21st century company. Inside the plant, director Phil Joanou, a veteran of Bud Light Super Bowl ads, was talking to the people working the robot: "More subtle! Subtle! Subtle!" The robot's reaction to dropping the screw seemed

overly dramatic. "Take 10!" Hirshberg looked on. "This shot is important, but it's not the one I'm worried about," he said. The shot that would make or break the story was when the robot is ushered from the factory. "I won't be able to sleep unless this hunk of metal looks forlorn."

On Jan. 11, Jackson viewed a version of the ad at his Los Angeles home. Hirshberg was on the phone, listening as his client watched. "It's a winner," said Jackson. "But let me ask my expert." Jackson's 13-year-old daughter, Erin, watched as Hirshberg listened. She said "Awwwww" and laughed in the right

places, he recalls. "It's not scientific," he says. "But it's important to know that even a kid gets the story."

But that wasn't the end. On Jan. 17, less than three weeks to airtime, some first-time watchers said the story line wasn't clear. The ad moved too fast. One viewer didn't get that the robot had been fired. On the way back to the agency, Hirshberg called Creative Director Mike Bryce, still toiling away in the editing studio. "We need better sounds out of the robot," Hirshberg told Bryce. "Put some sounds from R2-D2 into our robot and tell the studio we need some sounds more like that. And I think we have to take out some stuff in the middle to make the firing sequence more vivid. We're sunk if everybody doesn't get that."

SUICIDE WATCH

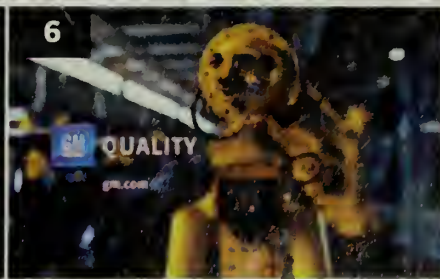
THE ROBOT WAS built by Stan Winston Studio, which devised R2-D2 30 years ago. But, unknown to Hirshberg, R2-D2's squeaks and buzzes were created by actors; the GM robot's utterances were based on mechanical sounds from power tools and car engines. Hirshberg and Bryce made the squeaks and grunts themselves; the audio techs did the rest. Suddenly the robot sounded more human.

The fretting didn't end there. To make sure the suicide scene seemed authentic, they viewed movies with bridge leaps (*Fearless*, *It's a Wonderful Life*). With just a week to the game, a version with a longer beginning and more emotive sounds was ready.

On Jan. 16, as Hirshberg kept tweaking, he videoconferenced with GM Chairman G. Richard Wagoner Jr., who loved the ad and gave Deutsch the \$200 million Saturn account. Of course, in an age of YouTube ad parodies, consumers have a lot of say over what advertisers do. They'll determine if the ad works—and if Wagoner's faith in Hirshberg is warranted. ■

BusinessWeek weekend

TV: To see many of this year's Super Bowl ads, watch our weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com to see video clips or type in your Zip Code to find when and where it airs in your area.



Building a Megabrand Named Dwyane

How Dwyane Wade of the Heat is rewriting the rules of sports marketing

BY ROGER O. CROCKETT

PRactice is over at American Airlines Arena, and Dwyane Wade takes a minute to explain how he's putting his touch on a new mobile phone. The All-Star guard for the Miami Heat and a self-proclaimed budding businessman is helping wireless carrier T-Mobile USA Inc. design a limited-edition Sidekick, the texting device/cell phone beloved by twentysomethings. "When I first saw the mockup they had with my signature, I said, 'I don't want my signature on it,'" he recalls. "When people get my signature it should be exclusive." T-Mobile followed what Wade's gut told him: Print his name in block letters, feature his logo, and install a softer back for better grip and durability.

Wade, 25, clearly knows what he wants, both on and off the court. He has emerged as the leader of the Heat, despite playing alongside such veteran stars as Shaquille O'Neal and Alonzo Mourning. He's a three-time All-Star in just four years in the league and led the Heat to last year's improbable victory in the NBA Finals, when the team won four straight games after losing the first two. His Michael Jordanesque drives to the hoop and game-winning shots earned him the series' Most Valuable Player award. "Dwyane kind of snuck up on people with how great a player he is," says NBA legend Charles Barkley.

Being so hot on the hardwood has led to a soaring off-court profile: *GQ* magazine cover boy in November; *Sports Illustrated* Sportsman of the Year in December; plus endorsement deals with Converse, Gatorade, and Topps. Wade has also landed contracts with companies beyond sports, including Lincoln autos, Staples, and T-Mobile. All these

deals total \$15 million to \$17 million, sources say. And now, Net search giant Google Inc. is in negotiations with Wade to try to revolutionize how celebrities are presented online.

HIGH SCHOOL SWEETHEART

WADE IS CHANGING the marketing landscape in ways other phenoms can learn from. He isn't simply endorsing products, he's partnering with major brands to design items other than sports equipment and apparel. On Feb. 17, the weekend of the NBA All-Star Game, the D Wade Sidekick—the T-Mobile device he co-designed—will debut with much fanfare.

What brand managers love about Wade is his wholesome appeal. In a league struggling to rid itself of the taint of brawls, criminal charges, domestic violence, and swaggering stars, Wade is a soft-spoken family man who married his high school sweetheart. He's not covered with tattoos. Modest and low-key, he's hip without the aura of urban menace. "He has the charisma," says agent Mark Steinberg, who represents Tiger Woods. "He has the qualities to become a great sports marketing superstar."

That's exactly what Wade and his high-powered handlers have in mind. Team Wade, led by agent Henry Thomas, aims to transform its young client into one of the top 10 brands in sports. They won't put a number on it, but to put their goals in perspective, Woods has earned an estimated \$650 million from all sources since he started playing

CHAMPION
Wade's family-man image is a marketer's dream

professionally. The idea, says marketing strategist Andrew Stroth of Chicago CSMG Sports Ltd., is to create a global brand that transcends sports. "For his peers in the NBA," he says. "We want people to think of Dwyane Wade the same way they think of [David] Beckham, Jordan, and Tiger."

That won't be an easy layup, however. First of all, it's tough for a team-sport athlete to achieve megastar status unless he soars far above his peers, like I



ness. Second, marketing an athlete is a risk-free, even when he or she has a squeaky-clean image. And third, some sports marketing experts question Team Wade's choices of branding partners, noting that too many, like Converse and T-Mobile, aren't leaders in their fields. As Stephen Wade Zucker, a Chicago-based sports agent: "You'd think he would be commanding the best dollars in the best brands. But he's not with the best brands."

WIN TO THE SHOELACES

Wade signed his first major endorsement deal, with Converse, before his first season, when he was a lesser-known player in the same rookie crop as Cleveland's LeBron James and Denver's Carlos Antonio. Converse, the shoe of Michael J. Magic Johnson, and Larry Bird, lost its luster during the 1990s as Jordan became Nike king. The company has also suffered quality problems.

Wade's original Converse contract was worth \$500,000 a year. But after Wade showed his mettle in the 2005 playoffs, his Converse contract was renegotiated to about \$10 million a year. In contrast, James had signed a shoe contract with Nike Inc. worth nearly \$100 million before he played one game in the NBA.

As part of the deal, Converse agreed to make not only Wade basketball shoes but also casual and active attire. He'll receive incentives based on the success of these breakout categories, says Ric Wilton, sports marketing chief at Converse. The latest Converse basketball shoe, the Wade 2.0, due in stores on Mar. 3, was created down to the shoelaces by Wade. Converse was bought by Nike in July 2003, and Stroth, defending Wade's

PLAYBOOK BEST-PRACTICE IDEAS

Way Beyond Sneakers

Key marketing steps from D-Wade's camp and beyond:

KNOW YOUR PRODUCT

Wade is an athlete, so the marketing he does off court has to be tied to his success on court. In his Lincoln auto ads, Wade helps kids who play ball, though he doesn't play in the spot.

CONVEY CORE TRAITS

Wade's managers aim to position him as a competitive, contemporary, humble winner. In an upcoming Gatorade ad, Will to Win, Wade mentally runs through the obstacles that face him on the court.

IDENTIFY THE TARGET MARKET

For Wade it's young adults, age 16 to 24. That's why he's partnering with T-Mobile on a new mobile device popular with youth.

ALIGN AUTHENTICALLY

A big brand is not always best. Wade's team chose T-Mobile over AT&T and Converse over bigger shoe companies because they fit his persona and what he uses himself.

INTEGRATE MARKETING PROGRAMS

T-Mobile is an ideal partner because it's also an NBA sponsor, allowing its ads to feature him in trademarked NBA gear.

LEVERAGE DIGITAL MEDIA

Wade is engaging Web giant Google to help create an online community with exclusive content via blogs, Webisodes, and podcasts.

sticking with the brand, says: "Converse is backed by the Nike engine, and it gives us the opportunity to reinvent Converse with Wade as the face."

And although it's not as big a brand as AT&T or Motorola, T-Mobile presented a special opportunity, says Stroth. The carrier is a \$100 million sponsor of the NBA. That means whatever marketing activities T-Mobile and Wade engage in can be tied to NBA events. In T-Mobile ads and promos, Wade can sport official NBA gear rather than generic apparel.

Adds Stroth: "We went after T-Mobile because he was excited about it. That's an important part of our strategy—to translate who Dwyane Wade is as a person." Wade, after all, already used the Sidekick and suggested a white and gold color scheme reflecting his taste. "You see me, you see my Sidekick," he says. "I don't go nowhere without it."

When the D Wade Sidekick is unveiled, T-Mobile will unleash a multimillion-dollar campaign "unprecedented" in NBA history, sources close to the league say. A



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BusinessWeek weekend

Hoop Dreams

huge billboard, featuring Wade in cre and gold with the new phone, will stre over 20 stories of the Mandalay Bay tel. "This is much bigger than anyth we've done before because of the stat that Dwyane has," says T-Mobile marl chief Michael Butler.

But the most in- novative aspect of the Wade brand- ing campaign may be its Web strat- egy—which was born from a mo- ment of serendipity in the sky. Team Wade had already launched a Web site but knew they needed to lever- age the Internet more effectively to



SIDEKICK Wade opted for the luxury look

engage his young fans. On Oct. 17, o flight from New York to Chicago, Stro sat next to a Google executive. Th agreed the two camps should meet.

LIVING THE DIGITAL LIFE

THE NEXT WEEK, in Chicago, Goo reps preached moving beyond "indep- dent sites" such as Wade's. Those si along with charity appearances, TV a and video games, make for an "episod- relationship between the athlete a fans. But digital media allow for brai to be built daily or hourly—what Goo calls "dialogue" marketing.

Wade, a Google user himself, liked t concept. So Team Wade gave Google the ahead to develop a plan that would m Dwyanewade.com an integral part fans' daily digital lives. Wade's camp a Google are in talks that they hope to c- clude by the end of March. The goal: a fully interactive site built by Google w Google Search functions embedded. F would get a customized mix of e-m sports news feeds, flash games, and p motional messages. Hundreds of W basketball videos exist on Google a YouTube, and Stroth wants to link th to Wade's site. "This notion of user-g- erated content is unbelievable," Stro says. "We want to fuel that."

Such a Digital Age strategy, Wa figures, will put him a step ahead rivals such as James and Anthony in race to be the next Jordan. Talking ab brand-building in Miami's arena, Sidekick in one hand and a basketball the other, he shows a flash of the fer- ity he brings to late-game heroics. " question about it," says D-Wade. "I w to be the No. 1 guy." ■



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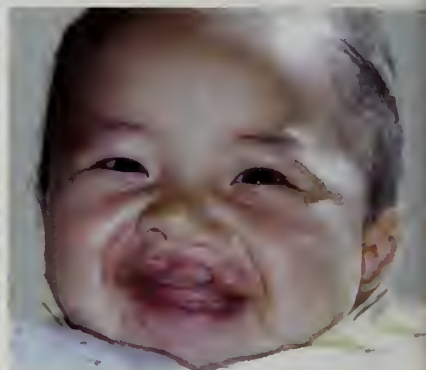
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Boonmee, 5 years, Cambodia



Xihao Teng, 1 year, China



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Cold Comfort



At Twin Farms, a five-star resort in Barnard, Vt., food is the main attraction. So bring your long johns, but forget about counting calories. **BY ADRIENNE CARTE**

IT'S A BRISK, BEAUTIFUL MORNING at Twin Farms, where the lightly falling snow sparkles like diamond dust in the early sunlight. Yet despite below-freezing temperatures and gusts of wind, coziness and calm pervade the dining room as guests warm themselves by the fireplace. Taking in the idyllic views from the boutique resort, nestled among 300 acres in the Vermont countryside, it's easy to shed the February funk as you tuck into a hearty breakfast of soufflé-like pumpkin-maple pancakes or poached eggs wrapped in Serrano ham and topped with a creamy swiss cheese pesto.

Dozens of exclusive retreats chase the winter blues away with pastoral settings, spa amenities, and blood-pumping activities, but few take food as seriously as Twin Farms, one of just 37 U.S. hotels in 2007 to get a five-star rating from the

highly regarded *Mobil Travel Guide*. As it does at The Point in Saranac Lake, N.Y., Blackberry Farm in Walland, Tenn., and Triple Creek Ranch in Darby, Mont., food takes center stage at this country inn in central Vermont. Almost every morsel is

delectable, from the locally made swiss white cheddar in the breakfast frittata to the freshly baked shortbread before bed.

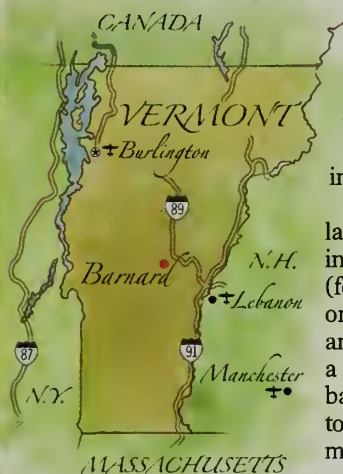
It's not surprising that the adult-only Twin Farms, with an environment that's both luxurious and laid-back, attracts an exclusive clientele looking for a respite from their frenetic lives. For \$1,100 to \$2,750 a night for two people, including all meals, drinks, activities, and transport from one of the three closest airports—in LeBarre and Manchester, N.H., and Burlington, Vt.—you should expect perfection, and Twin Farms comes pretty close.

The 20 rooms and cabins, all with at least one fireplace, are sumptuously appointed, each in a different motif.



DOWN ON THE FARM

Clockwise from opposite: Guests warm their toes behind the main house; the main dining room is just one of the options at mealtime; snowshoers pass a sculpture of a horse, part of the owner's extensive art collection; grilled shrimp over mascarpone-herb polenta



treat. One possible complaint about Twin Farms is that there's almost too much food. But given the quality and presentation, it's pretty hard to resist.

There are no menus at Twin Farms. Trained at the New England Culinary Institute in Montpelier, Vt., Chef Ted Ask, along with his team, visits local farmers and cooperatives each day to find the best seasonal and organic ingredients available, supplementing them with goodies from afar, such as truffles and Pacific salmon. In winter, Ask also has his pick of squash, pumpkins, fine herbs, and other items from the three-acre farm and greenhouse on the property. Guests can

make special requests, but you might as well sit back and enjoy Ask's creativity. For lunch one gray, snowy day, he conjured up a heartwarming turkey chili with black beans, corn tortillas, and charred green peppers, topped with crème fraîche. "We let the ingredients dictate the meals," says Ask.

As you might expect, dinner is the most lavish spread. The evening usually starts in either the sitting room or barn room (formerly a real barn) of the main house, once the retreat of writer Sinclair Lewis and journalist Dorothy Thompson. Order a cocktail from the extensive top-shelf bar while noshing on a crusty bruschetta topped with house-smoked duck and pear mostarda—a salty, sweet surprise.

DESSERTS TO DIE FOR

YOU CAN THEN ENJOY your meal in the main dining room or opt for a more secluded spot, such as the romantic wine cellar with its single table for two. Our first course one night featured braised chicken served with a roasted red beet risotto, chèvre-leek compote, carrot drizzle, and apple cider syrup. The sweetness of the dish paired well with a 2001 Flowers pinot noir. The entrée, a savory beef tenderloin with maple-parasip puree, rainbow chard, rutabaga, shiitake mushrooms, and a tangy red-onion marmalade, was ideal comfort food for the frigid night and went nicely with a bold 2001 Pride Mountain cabernet sauvignon. The chef misfired only once: The lobster and portabello mushroom Napoleon served the previous night could have used more flavoring.

Desserts at Twin Farms are also inspired. With its smooth and crunchy textures, the butterscotch pudding with brown sugar almond streusel, chèvre cream, and a crispy tuille was one of the best. With such decadence, the brochure should have a disclaimer: If you don't plan to be active, expect to go home a few pounds heavier. ■

meadow Cottage, which overlooks the property's private ski slopes, evokes *The Arabian Nights* with its tented ceiling and intricate mosaic tiles. The Studio is a modern feel, with contemporary furniture and original art by the likes of Roy Lichtenstein from the resort owner's private collection. Inside, guests can take in views of the white-cedar forest from the two-story window in the living room or the sunny hot tub on the sunporch.

KI, SKATE, SOAK

YOU CAN WORK UP an appetite and burn off a few calories enjoying the multitude of activities the resort has to offer. In winter you can snowshoe through seven miles of wooded trails, glide across the skating pond, or take the Poma lift up to one of the seven runs. For hard-core skiers looking for more of a challenge, Killington is just 30 miles away. Don't know how to ski? The creation staff will give you a lesson on

the slopes or guide you on a snowshoe tour of the property. No need to pack your equipment. Twin Farms has everything from skates to skis.

For those who want something more relaxing, there's always the spa. You'll find the usual assortment of treatments, such as exfoliating salt body scrub (\$130) and the personalized facial (\$135). The pub, where you can play a friendly game of pool, and the Furo, a giant sunken indoor hot tub, are popular congregating spots. You can even take a ride in a horse-drawn sleigh with a blanket and hot cocoa.

Whatever activities you choose during the day, it always comes back to the food. The staff will happily set up a bonfire in a snow-covered clearing so you can warm up as you enjoy a gourmet box lunch during a cross-country skiing expedition. Or have a cheese plate and bottle of wine delivered to your room for a post-massage

**Menus
are out.
Creativity
is in**

Pure Chocolate Indulgence

Aficionados, like wine lovers, care about where the beans come from. Now you can find sweets made of cocoa from a single country or plantation. **BY LAUREN YOUNG**

Origins

Overview

Tasting Notes



São Tomé

The first African cocoa plantations were planted in the 19th century on the islands of São Tomé and Príncipe, which is on the Equator off the coast of central Africa. The fertile, volcanic soil from Africa's smallest nation produces a forbiddingly dark, bittersweet chocolate.

The cocoa taste of Michel Cluizel's Tamarina No. 1 (left) is enhanced by licorice and citrus flavors. It is part of a five-plantation tasting box for \$26 (chocolatmichelcluizel-na.com). Fruit and spice dominate in the bittersweet Pralus São Tomé bar, which is \$8 (chocosphere.com).



Ghana

Ghanaian beans, usually at the bottom of the totem pole, tend to be used in mass-produced chocolates, but there are some standouts. Growers harvest pods by hand and ferment the beans between banana leaves on the forest floor.

Cocoa-dusted truffles from La Maison du Chocolat (left) are sweet, earthy, and mild at \$45 for half a pound (lamaisonduchocolat.com/en). Made from an aromatic cocoa, the Pralus Ghana bar, \$8, is a bit spicier with plenty of acidity to round it out.



Ecuador

Beans from Ecuador tend to have strong acidity because they are grown at high altitudes. Ecuadorian cocoa is more complex than African, but it's not considered to be top-tier. The country's best chocolate comes from the Salinas de Guaranda area, which is in the central region.

Hershey's Cacao Reserve Arriba bars (left) can be found at major retailers for just \$3.29. Because milk is used in production, true chocolate buffs will scoff at the sweet, herbal taste. For a more sensual experience, try Domori's Arriba bar, \$4.80. It boasts hazelnut, banana, and citrus flavors.



Venezuela

This South American country known for oil and Hugo Chávez is also a leading producer of high-end beans. But many so-called single-origin Venezuelan chocolates are actually a blend from several growing regions. Beans from Chuao and Porcelana are considered the best in the world.

Produced exclusively by Tuscan chocolatier Amedei in limited quantities, Chuao features notes of red currant and cherries. Even more rare is Porcelana (left). It tastes like bread and jam. Boxes of Amedei Porcelana and Amedei Chuao Napolitain are \$24 (www.amedei-us.com).

Sniff Before You Bite

Chocolate is best consumed at room temperature. Before you bite, break off a small piece, sniff it, and note the aroma. Then place it in your mouth and resist the temptation to chew. "The only way to bring the flavor out is to let it melt on your tongue," says David Siegel of Wow-Cacao!, which runs guided

tastings. With more than 1,500 distinct compounds, chocolate is complex, so your taste buds may detect many flavors. Between bars, cleanse your palate with water and bread.

For a well-rounded sampler, try the Pralus Pyramide Chocolate Square Stack (\$48), with varieties from 10 countries.

Chocophiles also recommend Valrhona Collection Gran Crus de Chocolat Noir (\$37). Both are available at chocosphere.com.

BusinessWeek.com

ONLINE: For a slide show on delectable Valentine's Day chocolates, click on www.businessweek.com/extras.

TELEVISION: To see a chocolate taste test, watch *BusinessWeek Weekend*.



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 **TOYOTA**
moving forward



BY ROBERT PARKER

The Good, the Bad, And the Overpriced

MAKING LISTS IS ALWAYS FUN because it generates both conversation and controversy. With that in mind, I thought I'd take a look at what in the wine world is hot and what's not, from Argentinian malbec and Italian prosecco (hot) to both red and white Burgundies and most any wine from New Zealand (not).

WHAT'S HOT

Spain's 2004 and 2005 vintages

Spain is the most fashionable wine producer in the world, and for good reason. Young Spanish winemakers respect their traditions but are also adopting practices from elsewhere that make for better and better wines. Nature lent a hand as well with two terrific vintages, 2004 and 2005.

Argentinian malbec

Isn't it odd that a grape that failed so miserably in France has thrived in Argentina? Whether they're \$10 table wines or premium-priced, limited-production selections from high-altitude Andean vineyards, these malbecs are rich, concentrated, complex, and deservedly popular.

Italian prosecco

French champagne is still the greatest sparkling wine, but there is a place for inexpensive, enjoyable bubbly. I find it in Italy's proseccos. Light as a delicate sea breeze, these sparklers rarely cost more than \$15 or \$20 a bottle. These are nonvintage wines that don't age well, so buy them from a retailer with rapid turnover.

Châteauneuf du Pape

The world is discovering the sumptuous

wines from this sun-drenched, windswept appellation in Provence. They're made from some of the oldest vines in France and are true expressions of terroir without makeup or manipulation. Some very good vintages between 1998 and 2005 (forget about the horrible 2002) have helped, too.

Paso Robles syrah and syrah blends

Young winemakers growing grapes on the limestone hillsides near Paso Robles, Calif., have had remarkable success here, especially with syrah. The wines improve with each vintage, and at \$20 to \$60 per bottle, the prices are fair given the quality.

Southern Italy

Terrific trattoria-style reds, and some pretty tasty whites and rosés, are coming from this hinterland known better for its tomatoes and scenic coastal drives than for wine. Look for

HOT: GERMANY's 2005s

These wines combine concentration, crisp acidity, and wonderful aromatics. For Mosel wines, especially, 2005 is one of Germany's best vintages.

nobles syrah. a
Châteauneuf du Pape. Proven
SYRAH
Germany
France. France. France.

NOT: "CRITTER" WINES

Marketers design labels with adorable animals to make the wines more appealing. The fact is, the labels are often far more interesting than what's in the bottles, and the market is already flooded with too many of these decidedly inferior wines.

reds from Puglia, especially those made from the aglianico grape.

Santa Barbara pinot noir and chardonnay

The movie *Sideways* focused attention on this area, a hotbed for high-quality pinot noir and chardonnay. The wines are fresh, lively, and complex. Wines coming from the Santa Rita Hills and Santa Ynez areas should be on your shopping list.

WHAT'S NOT

Bordeaux wine futures

The idea of paying for wine that won't be delivered for several years has never made much sense to me, except perhaps for the really great vintages that are few and far between. The wine world went nuts and overpaid for the 2005 Bordeaux. I predict there will be few takers for the 2006 futures when they hit the market in the spring.

Red and white Burgundy

For the last 10 years or so, expensive whites that should age well for at least 5 to 10 years have deteriorated in three to four. Quality is an issue for the reds, too. While 2005 is a very good vintage, 2004 was mediocre, especially for reds, and yet-to-be released 2006 looks like a loser for both.

Overpriced mediocrities from the Napa Valley

Too many producers with a Napa label think that's a license to charge two or three times what their wine is really worth. Some world-class, profound wines are coming from Napa, and Chateau Montelena, Colgin Cellars, and Harlan Estate are a few of the wineries making them. The great majority of Napa wines are the vinous equivalent of fool's gold.

Brunello di Montalcino

Italy's most historic and famous wine can be very good but is often too leathery, too tannic, and charmless. Producers cut from four to three years the amount of time the wine spends in the barrel, but it can still taste old even when it is just released.

Alsatian whites

As a student, I cut my teeth on the glorious wines made in this region of eastern France. The rieslings, gewurztraminers, pinot gris, and pinot blancs are sensational, but in the nearly three decades I have been writing about wine, they haven't caught on in the U.S. That's a shame.

Gigondas

This appellation could challenge Châteauneuf du Pape for supremacy in southern France/Provence, but winemakers there seem resistant to change. Some, like Santa Duc and St. Cosme, are improving the quality of their wines, but few of their neighbors are following them.

New Zealand

The cool-climate wines of New Zealand have long been popular with wine critics. But to me, the pinot noirs are often too vegetal and green, the sauvignon blancs reminiscent of cat pee, and the chardonnays grotesquely over-oaked. This is a country of young wine producers where everything remains a work in progress, but for now the prices of these wines do not translate to quality in the bottle.

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, *The Wine Advocate*.

For more Parker columns, go to businessweek.com/extras.

Not Just for The Big Guys

Now you can get into a private equity fund for as little as \$250,000. Is it the right time to make the leap? **BY AARON PRESSMAN**

THE MULTIBILLION-DOLLAR leveraged buyout deals have been coming fast and furious in the past few months, each bigger than the last. Amid the frenzy, the titans of private equity such as Blackstone Group, Thomas H. Lee Partners, and Texas Pacific Group reloaded their coffers with new funds of as much as \$15 billion. Overall, fund-raising reached a record of more than \$215 billion last year, according to Dow Jones Private Equity Analyst. Now Wall Street has come up with a few twists to open up private equity—previously restricted to institutions and wealthy individuals who can meet the \$10 million to \$25 million minimum invest-

ments—to the merely affluent. By pooling money from many, some new funds offer buy-ins for as little as \$250,000. Then, for diversification, the organizers divvy up the fund's millions among 5 to 10 private equity managers.

The allure of private equity comes from its stellar returns. From 1980 through 2005, private equity returned almost 18% a year, vs. 11% for the Standard & Poor's 500-stock index and less than 8% for 10-year Treasury notes, according to Thomson Financial. The high returns have come despite steep fees, typically 2% of assets per year plus 20% or more of the profits over a predetermined hurdle rate of return, usually the London interbank offered rate (LIBOR). The new funds of funds pitched to the affluent add yet another layer of fees that can run as high as 1.5% a year.

Even if investors can afford to get into a private equity fund, they

shouldn't leap at any opportunity. Not all funds of funds are the same, and few private equity investors actually earn the "average" return. That's because the highest returns are clustered in a small group of funds.

MEETING THE TEST

CONSIDER THIS: THE TOP 25% of private equity funds outperformed the median fund return by more than 10 percentage points a year over the past decade. That means most funds failed to beat even the stock market. "If you're not in the top quartile, you might as well not be in the asset class—you'd be better off in the S&P 500," says Christopher Cordaro, chief investment officer at financial advisory firm RegentAtlantic Capital.

Advisors and brokerage firms create their own funds and, typically, offer them during a limited subscription pe-

riod. Some also market to other managers' funds. The lowest-minimum funds are usually open only to investors who meet the "qualified client" test as defined in the federal Investment Advisers Act, says Scott Barrington, director of private equity at Piper Jaffray. That means a person or couple must have net worth of at least \$1.5 million. Investors also must meet the Securities Exchange Commission's criterion "accredited investors": \$1 million in investable assets, excluding personal real estate, or an income of \$200,000 a year. The SEC in December proposed raising that bar to \$2.5 million.

Even if you can qualify for a private equity investment, is this the best time to make it? There's a serious question of whether we're at the peak of a market cycle. Interest rates on junk bonds needed to complete the buyouts remain at rock-bottom levels, while the stock





Sizing Up **Private Equity** Investments

PRODUCT TYPICAL MINIMUM INVESTMENT	ANNUAL MANAGEMENT FEES	PROS	CONS
DIRECT VESTMENT 10 million	2% plus 20% of gains over predetermined hurdle rate	Access to best managers and lowest fees	High minimum, not diversified, 10-year lockup
REGISTERED FUND OF FUNDS 1 million	0.5% to 1% on top of underlying fund fees	Access to best managers, diversified by year and style of investments	High minimum, investor must meet qualified client criteria, 10-year lockup
UNREGISTERED FUND OF FUNDS 250,000	1% to 1.5% on top of underlying fund fees	Accessible, diversified by year and style of investments	Higher fees, may not have top funds, investor must meet qualified client criteria, 10-year lockup
POWERSHARES PRIVATE EQUITY ETF None	0.7%	Completely accessible to all, can sell at any time	No track record, may not track returns of private equity funds

Data: BusinessWeek

market continues to welcome initial public offerings of the LBOs when the private owners decide to cash in. Those conditions can't last forever.

Indeed, buyout funds started in the late 1980s and mid-1990s earned average returns closer to 10%. As competition for deals increased, firms paid higher and higher prices, leaving winning bidders saddled with huge interest costs that led to bankruptcies. And in periods when junk-bond financing dried up, private equity firms had to sit on the sidelines for years at a time.

NARROW FOCUS

The cycle is likely to repeat, so an investor considering a fund of funds should be wary of those that place all their money in offerings opened the same year. "We're more cautious and more selective than last year," says David Bailin, head of alternative investments at U.S. Trust. "If you're not careful, you'll subject yourself to a lot of risk over the next 10 years."

Another tactic is to shun big, broadly based buyout funds in favor of those zeroing in on an industry. One popular trend in 2006 was alternative energy, though the recent drop in oil prices has dampened interest. Other recent funds focused on infrastructure, health care for aging baby boomers, and supermarkets in developing nations.

For those who don't qualify for even the lower-minimum funds of funds or choose not to plunk so much down, there are more accessible private equity plays. Funds run by Kohlberg Kravis Roberts and Apollo Management started trading on Amsterdam's Euronext exchange last year and can be bought by U.S. investors through brokers that offer overseas trading. KKR Private Equity Investors trades at 22.95, down from 25 at its May initial public offering. Apollo's AP Alternative Assets fund is at 19.25, down from 20 at its July 31 IPO.

To get in on the private equity boom, PowerShares Capital Management created an ETF that tracks 30 public stocks involved in private equity both directly and indirectly. Some holdings, such as CIT Group, mainly offer financing to private companies while others like Affiliated Managers Group and UTEK specialize in making small and medium-size deals. What little trading history exists suggests that the PowerShares fund closely tracks the return of small-cap financial stocks. For investors who want private equity investments, there's no substitute for the real thing. ■



Trade Currencies Like a Hedge Fund

A new ETF allows you to profit from the disparities between national interest rates. **BY LEWIS BRAHAM**

SEEING THE WORDS "currency" and "hedge fund" together might cause investors who remember the financial crises of the late 1990s to raise their eyebrows. The collapse of the Thai baht in 1997 and the Russian ruble in 1998 triggered massive hedge fund losses that cost investors billions.

Now, through adroit financial engineering, Deutsche Bank and PowerShares Capital Management have come up with an exchange-traded fund that replicates a hedge fund strategy known as the "carry trade" used in currency markets. Since its September launch, PowerShares DB G10 Currency Harvest Fund has grown to \$180 million in assets

and 130,000 shares in daily volume.

Here's how it works: An investor buys the currencies of countries with high interest rates while selling short those

with low rates. The return comes from both interest income and the expected strengthening of the high-rate currency and the weakening of the low-rate one.

The ETF's benchmark is the Deutsche Bank G10 Currency Future Harvest Index. Although the carry trade is an old strategy, the index was created for the ETF and is only five months old. A Deutsche Bank back-test of the index generated noteworthy returns: 11.4% annualized average over 10 years (through Jan. 24), compared with 8% for the Standard & Poor's 500-stock index. The returns, which are just hypothetical, also showed that the index had less than half the volatility of the S&P 500. What's more, the carry trade returns had almost no correlation with stocks, meaning the ETF should be an excellent portfolio diversifier.

SHORTING THE YEN

STILL WARY? Unlike Long-Term Capital Management, the once-stellar hedge fund that invested in currencies and collapsed in 1998, this ETF invests only in the currencies of developed nations with high credit ratings. There's no leverage, either—a big factor in LTCM's implosion.

One reason for the carry trade's success is that Japanese interest rates have hovered near zero for years because of a weak economy. That has enabled hedge funds to short the yen and go long on currencies from countries with healthy economies and higher interest rates. In the ETF, the yen accounts for one-third of the short position, as does the Swiss franc and the Swedish krona (table). New Zealand, Australian, and U.S. dollars are on the long side. With interest rates in Japan at just 0.5% and those in New Zealand at 7.6%, the spread between the highest and lowest rate countries is wide. Of course, a much stronger yen or a weaker greenback could spoil the play.

Another wrinkle is the ETF's tax treatment. The fund uses futures contracts as proxies for currencies. With futures, 60% of any capital gains are taxed under long-term capital-gains rates and 40% under short-term rates, no matter how long the holding period.

More problematic is that the currencies' securities interest is not paid but instead is part of the way the futures are priced. So at tax time, shareholders end up having to report "phantom income"—money they've earned but not received—to the IRS. The fund makes a special distribution at yearend to cover those taxes, but there's no guarantee it will do so every year. ■

INTERNATIONAL SPREADS

Current holdings of PowerShares DB G10 Currency Harvest Fund

LONG POSITIONS	INTEREST RATE*
Australian dollar	6.31%
New Zealand dollar	7.59
U.S. dollar	5.36
SHORT POSITIONS	
Japanese yen	0.54%
Swedish krona	3.39
Swiss franc	2.16

*Jan. 24

Data: DeutscheBank



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THE NEW VALUE FRONTIER





BY GENE G. MARCIAL

A RESTRUCTURING COULD UNLOCK VALUE AT WEYERHAEUSER.

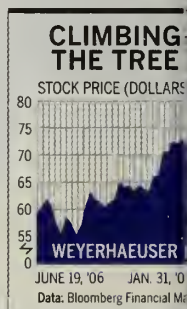
AT ARCHER DANIELS MIDLAND, THE STEEP SLIDE MAY BE OVER.

TWO PROMISING NEW DRUGS FROM ACCESS PHARMACEUTICAL.

Weyerhaeuser: A REIT?

SHARES OF WEYERHAEUSER (WY) kicked up 5.3%, to 71.93, on Dec. 15 when Franklin Mutual Advisers, which owns a 7.6% stake, filed a letter with the Securities & Exchange Commission urging the company to take action to boost profits and unlock its intrinsic value. The stock hit a new high of 75.32 on Jan. 29 and is still at 75. This leading forest-products company has become a "very attractive play in an otherwise boring industry—on both fundamental and technical factors," says Dawn Bennett, CEO of Bennett Group Financial Services. "The recent volatility in the stock caused by active options trading has attracted some big investors, which tells me there is a lot more upside to it." There is talk Weyerhaeuser will sell more land and timber assets, which Bennett says could take the stock higher. One option is to turn the company into a real estate investment

trust (REIT) for tax advantages and to make it more competitive. On Jan. 18, Weyerhaeuser named Debra Cafaro, a well-regarded REIT executive, to its board. That sends a "clear signal that Weyerhaeuser will be looking at moving its huge timberlands into a REIT," says Mark Wilde of Deutsche Bank, which owns shares and has done banking for the company. He rates the stock a buy. In 2006, Franklin Mutual pressured Potlatch, another forest-products outfit, in which it is the largest holder, to convert to a REIT, notes Wilde. It values Weyerhaeuser's timberlands alone at \$50 a share. It does not include other assets such as pulp, containerboard, building products, and construction. Wilde figures that, on asset valuation alone, Weyerhaeuser is worth 80.



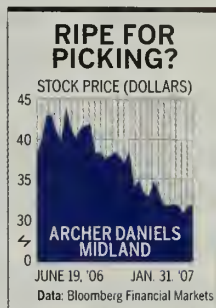
BOLD MOVES



**This test had a lot of turns.
And one big twist.
(Ford Fusion beat Camry and Accord.)**

The Lurking Hunger for ADM

ARCHER DANIELS MIDLAND (ADM) dropped from 56 in May to 32 on Jan. 31, and investors who were betting on strong demand for ethanol feel let down. Not Carl Birkelbach, president of Birkelbach Investment Securities, which owns shares. He sees ADM shooting back to 46 this year. "ADM is attractive, especially at this price, because of many things other than ethanol," he says. "It had gone up too far, too fast, when big institutions jumped in, to get out of their oil holdings," he notes. "Now ADM has gone back down just as it should, despite improving earnings," says Birkelbach. With 250 plants worldwide, ADM processes raw corn, soybeans, and wheat into ingredients for food manufacturing. Joseph Agnese, Standard & Poor's rates it a buy and sees faster earnings growth through 2007, partly due to biofuel demand. He expects profits of \$2.50 a share in 2007 vs. \$2 in 2006.



Access just inked a sales pact with a pharma in Europe and expects to find a U.S. partner soon. Its other product, ProLindac, now in Phase II clinical trials, is aimed at various oncology applications, including refractory ovarian cancer, a \$2.5 billion market. "This drug is a potential blockbuster," says Kevin Raidy of health-care hedge fund H4 Capital, which has a stake of close to 5%. MuGard's FDA approval, he says, "removes any risk in the stock," because that drug alone is worth more than the stock's current price of 2.95 a share. He sees Access climbing to between 10 and 20 in two years. Steven Rouhandeh, chairman of SCO Capital Partners, the biggest stakeholder, with 30%, says Access is at the top of his portfolio because of the huge potential of MuGard and ProLindac. "The stock is incredibly undervalued," he says. ■

How Access Helps Treat Cancer

ACCESS PHARMACEUTICALS (ACCP) is a tiny biotech trading over the counter. But its two cancer drugs—one of which, MuGard, is already O.K.'d by the Food & Drug Administration—are catching the eye of investors. Oracle Investment Management, a top-ranked health-care hedge

BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

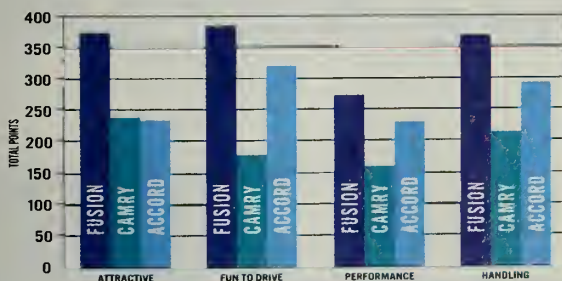
Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Recently, in Washington, D.C., a town known for its strong opinions, *Car and Driver* invited 600 of its readers to compare three cars in performance, handling and styling.

So, who won? Camry? Accord?

Actually, the all-wheel-drive Ford Fusion came in first. If that surprises you, then find out what these *Car and Driver* enthusiasts have already discovered.

Check it out yourself. Visit a Ford Dealer or go to fusionchallenge.com.

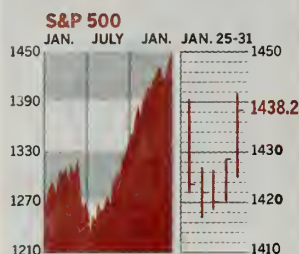


Results from 600 drivers who were asked if the cars were attractive, were fun to drive, performed well and handled with precision. "Yes" responses scored one point. "No" responses scored zero. The results speak for themselves.

FUSION
CHALLENGE



STOCKS



COMMENTARY

Markets reacted favorably to a strong fourth-quarter GDP number and the Fed's post-meeting press release, boosting the broad indexes back to where they were a week ago. Strong fourth-quarter earnings propelled Boeing and Caterpillar shares 7% and 2%, respectively. Shares of Amgen and 3M fell after earnings came in below expectations.

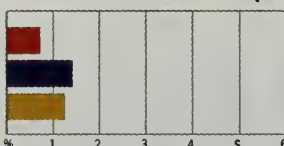
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED JAN. 30

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED JAN. 30

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	JAN. 31	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1438.2	-0.1	1.4	12.4
Dow Jones Industrials	12,621.7	0.0	1.3	16.2
NASDAQ Composite	2463.9	-0.1	2.0	6.9
S&P MidCap 400	833.0	0.7	3.6	6.7
S&P SmallCap 600	408.0	1.0	2.0	7.4
DJ Wilshire 5000	14,471.8	0.1	1.8	11.9

SECTORS

	JAN. 31	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	812.4	-0.1	1.7	5.1
BW Info Tech 100**	452.7	-0.8	1.2	15.4
S&P/Citigroup Growth	660.4	-0.4	1.2	8.2
S&P/Citigroup Value	776.5	0.1	1.6	16.6
S&P Energy	447.1	-0.1	-1.8	5.4
S&P Financials	498.8	-0.6	0.7	16.1
S&P REIT	215.8	2.3	8.5	31.3
S&P Transportation	267.7	-0.6	1.5	3.4
S&P Utilities	185.9	0.4	-0.4	13.8
GSTI Internet	202.2	0.6	1.2	-2.1
PSE Technology	891.9	0.2	1.9	2.2

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	JAN. 31	WEEK	% CHA YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	2006.2	0.5	0.8
London (FT-SE 100)	6203.1	-1.8	-0.3
Paris (CAC 40)	5608.3	-0.5	1.2
Frankfurt (DAX)	6789.1	0.6	2.9
Tokyo (NIKKEI 225)	17,383.4	-0.7	0.9
Hong Kong (Hang Seng)	20,106.4	-3.4	0.7
Toronto (S&P/TSX Composite)	13,034.1	0.2	1.0
Mexico City (IPC)	27,561.5	0.8	4.2

FUNDAMENTALS

	JAN. 30	WEEK AGO	YE TO DATE
S&P 500 Dividend Yield	1.77%	1.78%	1.7
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.6	
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1	1
First Call Earnings Surprise*	4.36%	5.06%	3.2

*First C

TECHNICAL INDICATORS

	JAN. 30	WEEK AGO	YE TO DATE
S&P 500 200-day average	1330.0	1326.7	Posit
Stocks above 200-day average	77.0%	75.0%	Negat
Options: Put/call ratio	0.90	0.88	Posit
Insiders: Vickers NYSE Sell/buy ratio	5.89	6.26	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Tires & Rubber	17.6	Tires & Rubber	59.5
Steel	16.0	Steel	58.7
Office REIT's	14.2	Intgrd. Telecomms. Svcs.	42.5
Constr. Materials	13.3	Constr. Materials	41.7
Retail REIT's	12.1	Department Stores	41.4

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Distillers & Vintners	-8.4	Gold Mining	
Instrumentation	-7.0	Electric Mfg. Svcs.	
Food Wholesalers	-6.0	Education Services	
Consumer Electronics	-5.4	Homebuilding	
Property & Casualty Ins.	-4.3	Oil & Gas Refining	

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	4-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	6.1	Real Estate	32.8
Health	2.8	Pacific/Asia ex-Japan	30.8
Mid-cap Growth	2.5	Europe	25.5
Mid-cap Blend	2.3	Latin America	22.9
LAGGARDS		LAGGARDS	
Precious Metals	-1.3	Japan	-4.3
Diversified Emerging Mkts.	-0.7	Natural Resources	-0.6
Natural Resources	-0.5	Technology	2.4
Latin America	0.0	Small-cap Growth	3.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	4-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Volumetric	20.2	Dreyfus Prem. Grtr. China A	68.8
Frontier MicroCap	11.1	Old Mut. Clay Finlay Ch. A	59.6
ProFunds Real Est. Inv.	11.1	Oberweis China Opport.	55.5
iShares MSCI Malaysia Idx.	9.4	Matthews China	54.6
LAGGARDS		LAGGARDS	
Matthews Korea	-6.6	DireXn. Emrg. Mkts. Short	-33.4
ProFunds Short Real Estate	-6.5	DireXn. Dev. Mkts. Bear 2X	-33.2
ProFunds Precs. Mtls. Inv.	-6.2	American Heritage Grth.	-25.0
iShares GSCI Comdty. Idx.	-5.5	ProFunds Precs. Mtls. Inv.	-24.8

INTEREST RATES

KEY RATES

	JAN. 31	WEEK AGO	YE TO DATE
Money Market Funds	4.87%	4.86%	3.9
90-Day Treasury Bills	5.11	5.13	4
2-Year Treasury Notes	4.92	4.93	4
10-Year Treasury Notes	4.81	4.81	4
30-Year Treasury Bonds	4.91	4.91	4
30-Year Fixed Mortgage†	6.30	6.12	5

†BancQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30-YR. B.
General Obligations	3.92%	4.2
Taxable Equivalent	5.60	6.1
Insured Revenue Bonds	4.01	4.5
Taxable Equivalent	5.73	6.4

THE WEEK AHEAD

NONMANUFACTURERS' INDEX

Monday, Feb. 5, 10 a.m. EST » The Institute for Supply Management's nonmanufacturing activity index for January is forecast to have eased slightly to 56.3%. That's the median forecast among economists queried by Action Economics. The December index edged down to 57.1%. In December more respondents—consisting mostly of service-sector purchasing managers—reported a

decline in new orders than in any month for three years.

PRODUCTIVITY & COSTS

Wednesday, Feb. 7, 8:30 a.m. EST » Gains in output per hour worked likely hit an annualized rate of 1.1% for the fourth quarter, following a small 0.2% increase in the third quarter. Compared with the same period a year ago, third-quarter productivity growth, at 1.4%, was the weakest since mid-1997. Unit labor costs probably

accelerated to an annualized pace of 3.1%, from 2.3%.

INSTALLMENT CREDIT

Wednesday, Feb. 7, 3 p.m. EST » In December consumers very likely accumulated \$5 billion of debt, following a \$12.3 billion jump in November. The gain came largely in revolving credit, made up mostly of credit cards, which surged by \$8.6 billion. Nonrevolving credit also rose as auto sales improved a little.

The *BusinessWeek* production index improved to 292.1 for the week ended Jan. 20, an 8.2% gain from year ago. Before calculation of the four-week moving average, the index dropped to 291.2.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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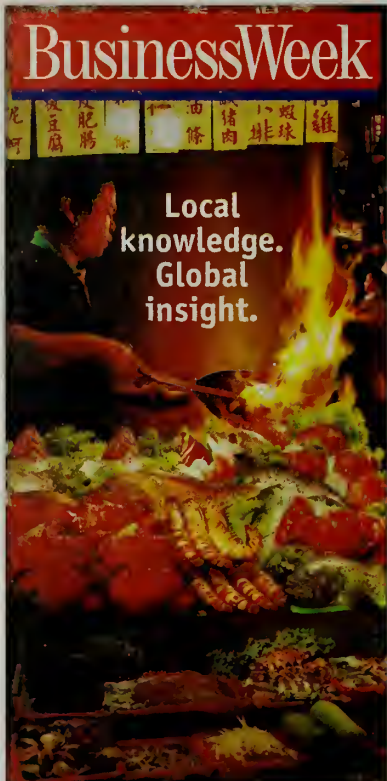
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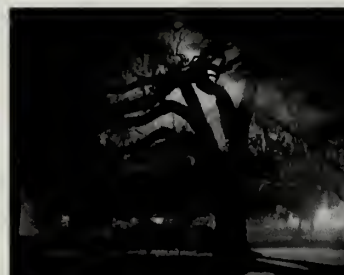
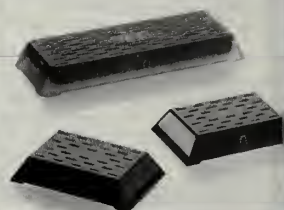
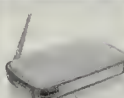


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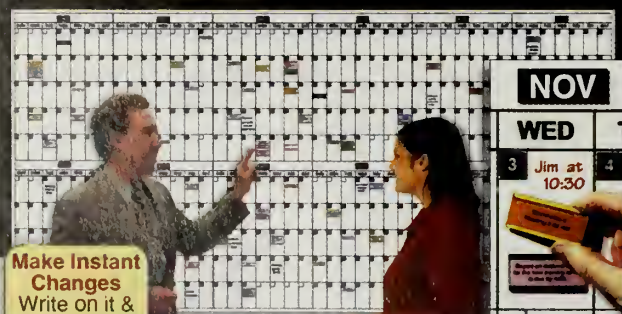
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The Indian Paradox

IN SPITE OF THE GODS The Strange Rise of Modern India

By Edward Luce; Doubleday; 383pp; \$26

James Paul, 29, is emblematic of India's new dynamism. The son of lower-middle-class Christian schoolteachers from the southern state of Kerala, he is a graduate of the elite Indian Institute of Technology in Mumbai. His parents were forced to take out a loan to fund his \$120-per-term tuition. It paid off: Paul

now manages a 1,500-person business unit at Bangalore software giant InfoSys Technologies Ltd., where he was hired in 1998. His salary has jumped tenfold in a decade, to \$50,000, a huge sum given the area's low cost of living.

India, as anyone who hasn't had his eyeballs permanently affixed to a Sony PlayStation knows, is an economic juggernaut. In 2005, while launching its first bank in the country, General Electric Co. projected double-digit revenue growth in Indian banking far into the future. "No one blinked," observes author Edward Luce. But weighing against GE's glowing assessment is the nation's widespread poverty: More than 300 million people live in squalor in the country's 680,000 villages, where both land and water are in short supply. Many homes are made with buffalo dung and feature charcoal hearths whose fumes worsen the symptoms of a prevalent disease, tuberculosis. Only 65% of the population can read, and in the villages that number falls as low as 33%. (China's literacy rate is 90%.)

Luce graphically depicts these conflicting forces in *In Spite of the Gods: The Strange Rise of Modern India*. From 2001 to 2005, the author was based in New Delhi as a correspondent for *The Financial Times*. His experiences ran the gamut: He visited InfoSys' plush, Googleplex-like office suite in Bangalore, as well as bustling call centers in Mumbai and publishing subcontractors in Chennai. In one of the country's poorest states, Uttar Pradesh, he shared a meager ration of boiled milk with a family of eight who depend on two acres of dry farmland to get by. And he regularly conversed with political leaders including Prime Minister Manmohan Singh. Drawing from these experiences as well as his own life—his wife is Indian—Luce provides a balanced, deeply personal chronicle of the frenetic and often contradictory political, religious, and economic dynamics that drive the country.

Prior to 1991, India's economy operated under a tight system of state controls and permits known as the License

Raj. Its dismantling under Prime Minister P.V. Narasim Rao transformed the country. The number of television channels expanded from 1 to more than 150. As foreign investment rose, the number and types of clothing store newspapers, and other products also increased. Since that time annual economic growth has averaged 6%. But unlike China, where labor-intensive industry dominates enterprise in India tends to be more capital-intensive and more reliant on skilled employees. There aren't enough for the millions who want the middle-class lifestyles they see on TV. Fewer than 10% of India's 470 million workers are employed in the formal economy, and only 35 million people pay income tax.

Layers of bureaucracy still encumber India's government, and corruption impedes the policy changes that would stimulate growth. At one point, Luce visits V. J. Kurian, head of Kerala's highway department. In 1980, on building an airport in the port town of Cochin some years back, Kurian had to fight endemic dishonesty. He was offered a \$200,000 bribe to accept the second-lowest bid for runway construction, but he refused. As punishment, he was transferred to an obscure job for two years. In the end, the airport got built and is today profitable. Kurian had to go along to get along. He is now quick to grant fellow bureaucrats airline upgrades and other small favors.

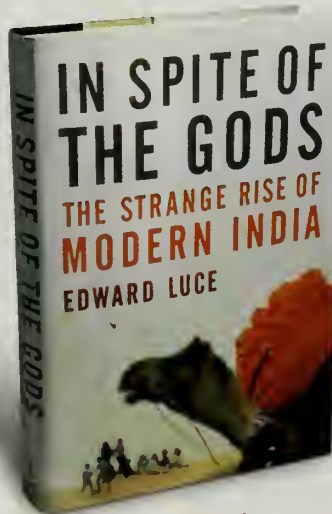
Such vivid anecdotes make *In Spite of the Gods* a pleasure to read.

The economy is surging, yet more than 300 million people live in squalor

Two-thirds of the way through, though, there's a surfeit of detail on the workings of India's political parties. And Luce's prescriptions for the would-be superpower are hardly novel: Address energy needs, public health, and poverty. Change labor laws to discourage hiring. Few would take issue, but the reader wants something more profound.

At the heart of India's problems lies a great paradox, which Luce ably describes: Democracy and meritocracy are huge assets as they permit economic change and promote such harmony as is possible in a land with 18 official languages and deep religious and caste divisions. Yet an open society is also a curse, given that it is sustained by a massive bureaucracy that addresses the multitude of groups while often blocking needed reform. Does regimented China offer a better model? Luce says no. The likes of James Paul provide his strongest argument.

—By Jessi Hen



The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS		LAST MONTH	MONTHS ON LIST
JIM CRAMER'S MAD MONEY James J. Cramer with Cliff Mason (Simon & Schuster • \$25) <i>More investing wisdom from the television personality.</i>	—	1		1 GOOD TO GREAT AND THE SOCIAL SECTORS Jim Collins (Collins • \$11.95) <i>A primer on how noncorporate organizations can excel.</i>	1	13	
FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • \$27.95) <i>Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.</i>	3	21		2 WHAT COLOR IS YOUR PARACHUTE? 2007 Richard Nelson Bolles (Ten Speed Press • \$17.95) <i>The enduring job-search bible.</i>	2	5	
THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • \$30) <i>Globalization is great—sort of.</i>	2	20		3 J.K. LASSER'S YOUR INCOME TAX 2007 The J.K. Lasser Institute (Wiley • \$17.95) <i>Brace yourself.</i>	—	1	
WHY WE WANT YOU TO BE RICH Donald J. Trump, Robert T. Kiyosaki, Meredith McIver, Sharon Lechter (Rich Press • \$24.95) <i>Help for the shrinking middle class.</i>	1	3		4 COLLAPSE Jared Diamond (Penguin • \$17) <i>From Easter Island to Mayan Central America, why civilizations fall apart.</i>	4	11	
BLINK Malcolm Gladwell (Little, Brown • \$25.95) <i>Snap judgments deserve careful consideration, says a writer for The New Yorker.</i>	4	24		5 THE AUTOMATIC MILLIONAIRE David Bach (Broadway • \$12.95) <i>It's time to put your investment program on autopilot.</i>	9	12	
JIM CRAMER'S REAL MONEY James J. Cramer (Simon & Schuster • \$26) <i>The "10 Commandments of Trading," from CNBC's wild man.</i>	5	21		6 BANKER TO THE POOR Muhammad Yunus (PublicAffairs • \$15) <i>The autobiography of the Nobel-winning founder of microlender Grameen Bank.</i>	12	2	
CROSLEY Rusty McClure with David Stern and Michael A. Banks (Clerisy Press • \$24) <i>The family of inventors, broadcasters, and owners of the Cincinnati Reds.</i>	—	1		7 THE ESSAYS OF WARREN BUFFETT Warren E. Buffett, Lawrence A. Cunningham (Cunningham Group • \$25) <i>A selection of epistles to Berkshire Hathaway shareholders.</i>	10	2	
THE STARBUCKS EXPERIENCE Joseph A. Michelli (McGraw-Hill • \$21.95) <i>How the coffee retailer built its following.</i>	7	2		8 THINK AND GROW RICH Napoleon Hill (Ballantine • \$7.99) <i>Willpower and a positive attitude are the keys to achieving wealth.</i>	6	20	
THE TAO OF WARREN BUFFETT Mary Buffett, David Clark (Scribner • \$19.95) <i>Wisdom from the Sage of Omaha, compiled by a former daughter-in-law.</i>	14	2		9 THE INTELLIGENT INVESTOR, REVISED EDITION Benjamin Graham, with Jason Zweig (HarperBusiness • \$19.95) <i>The classic treatise on "value investing."</i>	5	20	
OUR ICEBERG IS MELTING John Kotter, Holger Rathgeber (St. Martin's • \$19.95) <i>Dealing with change.</i>	—	3		10 THE ABC'S OF REAL ESTATE INVESTING Ken McElroy (Warner • \$16.95) <i>Advice from the Rich Dad's bookshelf.</i>	—	1	
BEYOND BASKETBALL Mike Krzyzewski with Jamie K. Spatola (Warner Business • \$17.99) <i>Duke's roundball coach on winning, losing, sportsmanship, etc.</i>	9	3		11 CRUCIAL CONVERSATIONS Kerry Patterson, Joseph Grenny, Ron McMillan, Al Switzler (McGraw-Hill • \$16.95) <i>Strategies for those all-important talks.</i>	—	11	
MAVERICKS AT WORK William C. Taylor, Polly LaBarre (Morrow • \$26.95) <i>Profiles of nonconformists in business.</i>	—	2		12 RICH WOMAN Kim Kiyosaki (Rich Press • \$18.95) <i>How women can take control of their finances.</i>	8	8	
THE TOTAL MONEY MAKEOVER Dave Ramsey (Thomas Nelson • \$24.99) <i>Get rid of debt and build up your reserves.</i>	10	23		13 FIND IT, FIX IT, FLIP IT! Michael Corbett (Penguin • \$15) <i>You can profit from real estate, by a TV show host.</i>	7	11	
JEFFREY GITOMER'S LITTLE GOLD BOOK OF YES! ATTITUDE Jeffrey Gitomer (Prentice Hall • \$19.95) <i>Accentuate the positive.</i>	—	1		14 THE TOTAL MONEY MAKEOVER WORKBOOK Dave Ramsey (Thomas Nelson • \$17.99) <i>Whip your finances into shape.</i>	11	9	
THE LONG TAIL Chris Anderson (Hyperion • \$24.95) <i>The mass market and the blockbuster product are giving way to a "mass of niches."</i>	6	6		15 THE ERNST & YOUNG TAX GUIDE 2007 Ernst & Young LLP (CDS Books • \$16.95) <i>Sharpen those pencils and get out the W-2s.</i>	—	1	

LONG-RUNNING BEST-SELLERS

HARDCOVER BUSINESS BOOKS

GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50)
W. DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$30)
DO YOU MOVE MY CHEESE? Spencer Johnson (Warner • \$19.95)
THE FIVE DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass • \$22.95)
THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Free Press • \$19.95)

PAPERBACK BUSINESS BOOKS

RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$16.95)
THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95)
GETTING THINGS DONE David Allen (Penguin • \$15)
THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • \$15)
THE 48 LAWS OF POWER Robert Greene (Penguin • \$18)
GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$15)

THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$15)
THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16)
RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$17.95)
RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki with Sharon L. Lechter (Warner • \$19.95)
RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99)
SMART WOMEN FINISH RICH David Bach (Broadway • \$14.95)

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in December. Titles that have been on the Best-Seller list for more than two years appear as Long-Running Best-Sellers.



Ideas FaceTime

WITH MARIA BARTIROMO

The Good News Economy

WITH THE U.S. ECONOMY growing at a 3.5% rate in the fourth quarter of 2006 and a stock market that keeps steaming ahead, the battered Bush Administration has at least one glowing success amid the gloom. On Jan. 31, as George W. Bush took his message of economic cheer to Wall Street, I caught up with Al Hubbard, director of the National Economic Council and one of the President's top advisers.

Do you think Americans feel better about the economy today than when President Bush first took office?

I'm not sure if Americans feel better, but most Americans at that time didn't know that the economy was headed into a recession and that we would face a series of economic blows. When the President took office, the economy had already begun to feel the impact of the bursting of the stock market bubble. Real GDP actually declined in the third quarter of 2000. The Dow had been on a steady decline for the 12 months before the President was inaugurated, and the NASDAQ was at a fraction of its record close. After the bubble burst, of course, we had the devastating economic impact of 9/11, and then the corporate scandals that rocked investors' confidence. We faced enormous challenges, but thanks to the hard work and risk-taking of the American people, and a wise mix of public policies, the recession was shorter and an investment-led recovery began that has evolved into a sustained expansion with solid growth in employment, wages, and earnings.

But the average middle-class American will tell you his job isn't secure, his paycheck doesn't cover the bills, and he's worried about his family's future. What do you say to him?

This is an interesting question because consumer sentiment is near five-year highs, consumer spending continues to grow, and business investment remains strong. These are not indices one would expect from a nation beset by pessimism.

In the latest NBC News/Wall Street Journal poll, a majority disapproved of President Bush's job performance and his

handling of the economy. Where do you think this anger is coming from?

I think the lack of progress in Iraq has taken a big toll on the way people look at things. I think it is difficult for them to separate the insecurity created by international terrorism and the troubles we are experiencing in Iraq from the robust economic growth here at home.

How would you characterize the economy today?

Every consensus forecast I have seen predicts solid growth in 2007. And that was even before this week's pleasant surprise for fourth-quarter GDP. The economy added jobs for 40 consecutive months, the unemployment rate is below the average for the 1990s, and, most important, real hourly wages for production and nonsupervisory workers increased 1.7% over the past 12 months. That's an extra \$1,030 of new purchasing power for the typical family of four with two wage earners.

Social Security privatization is back on the table. What will the Social Security plan look like?

Last year the President proposed creating personal retirement accounts to allow people—particularly those not currently invested—to own their own part of their retirement.

we understand that some people on the other side of the aisle don't like that idea. But...people need to say what they're not just what they're against. If no one is willing to step forward with a better idea, then we've got to work with the ideas that are out there.

The stock market has had a nice rally of late. But some people feel it's more important for Americans to have extra money in their paychecks through a hike in the minimum wage.

The President supports a minimum wage increase that is coupled with tax relief for small businesses. As long as the package includes targeted tax relief to help small businesses afford most by a minimum wage increase, he will support it.

What are the top economic priorities for the President's first two years in office?

Making tax relief permanent and finding a solution to the entitlement problems we face as a nation. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.



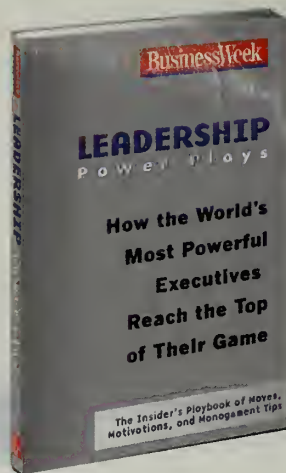
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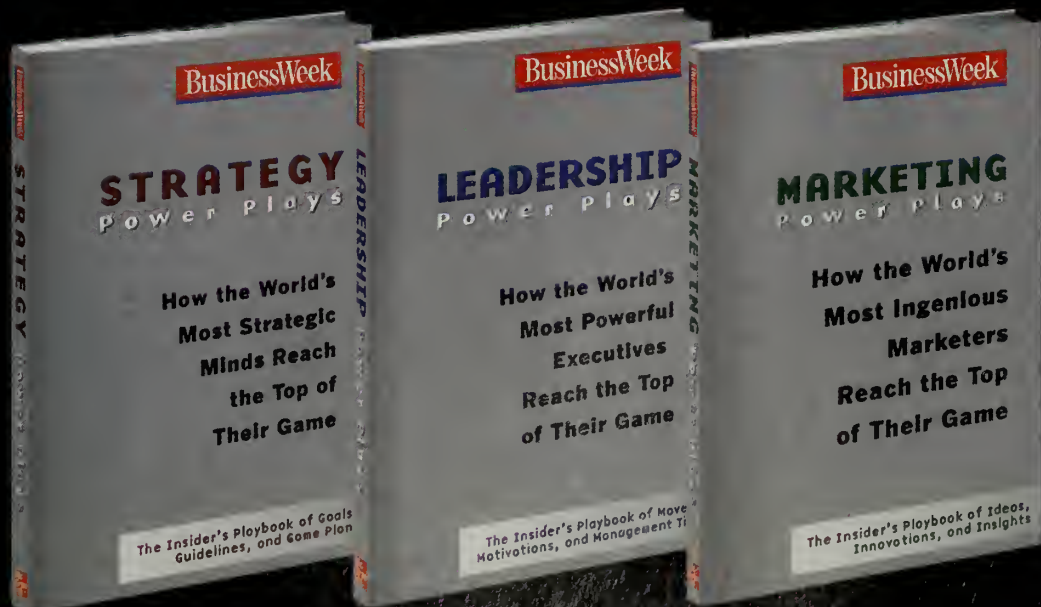
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

Company Man or Free Agent?

I've worked for five years at a very successful company where many exciting challenges lie ahead. But I know that the independent contractors employed by my department earn a lot more than I do—in some cases, almost triple. So I find myself at a crossroads: Should I go out on my own as a “hired gun” or stick it out as a company man?

—Anonymous, Dublin

You hail from one of the world's most robust economies, but your question is universal—it's the “it” career question of our times, and not just for newly minted college grads or MBAs. Virtually all businesspeople with some form of marketable expertise have the opportunity to outsource themselves to the growing number of employers attracted by the flexibility of hiring people without “chains.” As one such employer told us recently: “Independent contractors make my life so easy. I don't have to pay their benefits, write their appraisals, or manage their neuroses.” Best of all, she added, “if things don't work out, I don't have to roll in the muck with HR or legal. I can just say: ‘So long.’”

The deal can work nicely for independent contractors, too. They can maximize their earning power by working for several companies at once, working overtime, or working just as much as their needs require, and all while they enjoy being their own boss. Who needs snarky office politics, prescribed vacation time, and tedious annual 360-feedback evaluations when you can own your own life? What you lose in job security and insurance benefits you can make up in income and freedom.

BUT HOLD ON. Even in the brave new economy, there is still a case to be made for working at a company, and you allude to it in your question. It is the excitement of being part of something bigger than yourself and the thrill of building something—a product, a service, or a team. It is the fun of laughing, debating, sweating it out with fellow travelers—friends and allies in the never-ending competition for customers and profits. Say all you want about the joys of independence, but you can't claim that you and your BlackBerry on a plane can give you the same high as being in a room full of co-workers when word comes in that you've won a hard-fought contract. It just doesn't get any better.

If you're that kind of person.

And of course, that is what your crossroads decision comes down to: nothing more or less powerful than personal fit.

Some people are company people in their bones. They start joining sports teams and clubs as kids and seek experiences replete with camaraderie their whole lives. These types love the identity of belonging to an organization. The association makes them feel not overwhelmed or diminished, but fulfilled. Many people in this category are also energized by the prospect of leadership. They are the types of men and women who a us, in countless e-mails and everywhere we travel: “How can I be the best manager in the world?” and “How do I to be a CEO someday?”

There are also lots of people for whom being a manager or CEO has no appeal whatsoever, not to mention their lukewarm feelings about required organizational mush: strategic planning, budgeting, and the like. Years ago, one of us (Suzy) sat with a friend in a Sante Fe movie theater watching *Working Girl*. The moment an office scene appeared, the friend loudly announced: “Ugh—never!” eliciting a smattering of applause from others in the audience. Her business? Buying and selling jewelry from her basement. Her job description? Sole proprietor and entrepreneur.

Speaking of that, entrepreneurship is surely a third category to consider when you think about career fit. Entrepreneurs have characteristics of both independent contractor and company types. They want to build and belong—but to something of their own invention. This path, lucky for the economy, continues to attract some of the smartest, most passionate people in the world. In fact, during our recent speaking tour of 35 campuses, we'd estimate that 20% to 25% of the MBAs told us they want to start their own businesses.

From your question, that doesn't sound like your particular dream. Perhaps it has too much risk. Perhaps you don't have a big idea right now. And so, like many professionals today, you are left deciding between two very different career paths, both with virtues and drawbacks. Your decision isn't permanent, but it is huge and it will change your life. So imagine that life 5, 10, and 20 years from now. What do you want to be?

The choice is all yours.

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.



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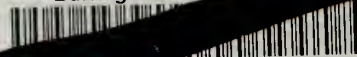
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It's a Low, Low, Low, Low-Rate World

Why money may stay cheap
longer than you think

BY MICHAEL MANDEL & DAVID HENRY (P.32)

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AND JUST LIKE THAT, THE LAWS OF CHEMISTRY CHANGE. A world that includes

the Human Element, along with hydrogen, oxygen and the other elements, is a very different world



indeed. Suddenly, chemistry is put to work solving human problems. Bonds are formed

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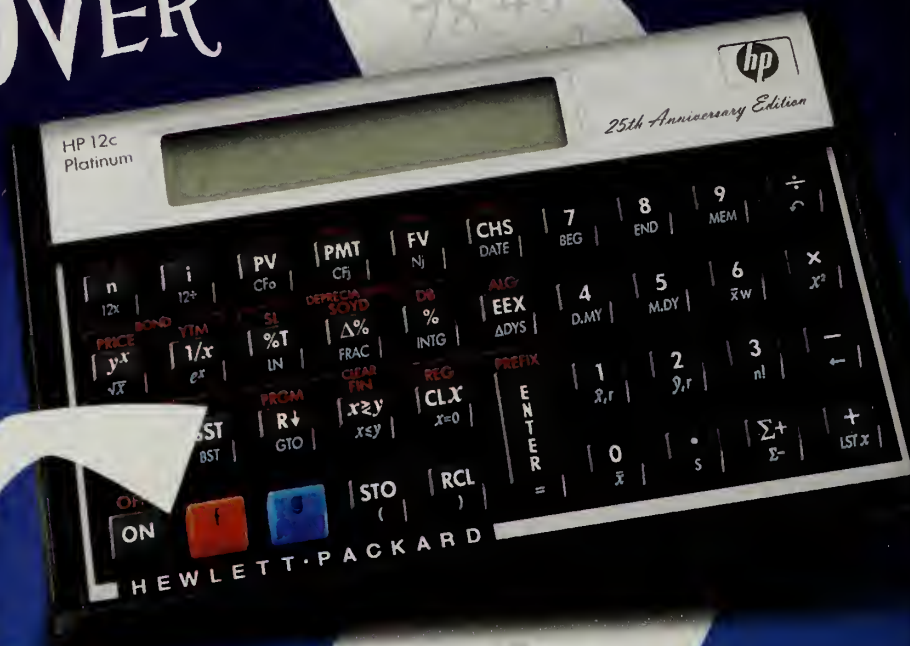
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Cooper says capital spending, which
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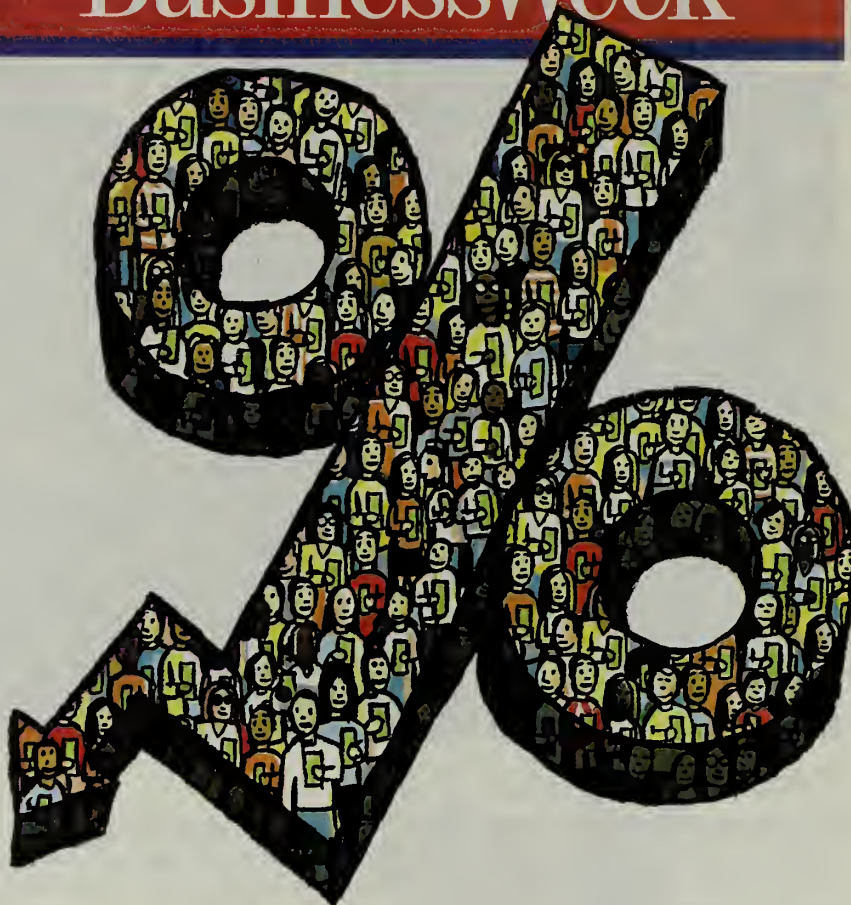
Shanghai Rising

Renaissance Florence, London
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century, Shanghai aims to muscle
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omic order—a role it played back in
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acefully melding the old and the
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Rivals allege hardball tactics

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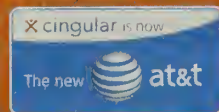
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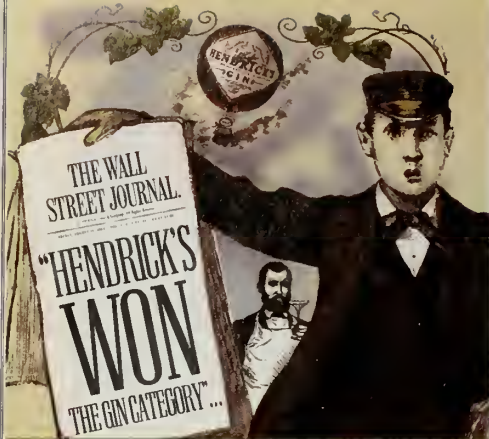
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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TOP 3 GINS

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\$30/750ml Flavorful

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\$26/750ml

Juniper Green Organic Best
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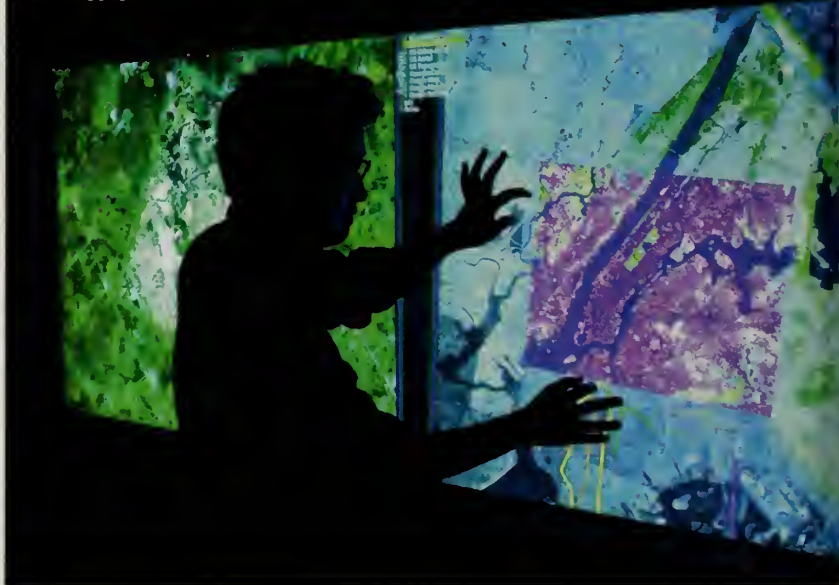
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E-maps: More digital devices are touch-sensitive



Getting in Touch with Tech

Apple CEO Steve Jobs set the tone for the year in tech with the iPhone, a phone and music player with a screen that lets users call up features by touch rather than with buttons. It puts Apple at the forefront of a movement toward **touch-sensitive devices** that could reshape consumer electronics—one of several trends we spotlight in a **BusinessWeek.com Special Report: Eight Top Tech Trends in 2007**. A lot of what's noteworthy will be happening on the Web. Microsoft and other tech titans may realize visions for delivering entertainment via so-called Internet TV. And this could be a breakout year for small business to become big Web advertiser now that companies like Google and eBay have unveiled a host of new services. Back in the physical world, Western companies such as Qualcomm and Intel will step up efforts to woo customers in developing countries. For a look at **the changing face of technology**, see our slide show featuring the big crop of up-and-comers that could be grabbing headlines next year. Go to www.businessweek.com/go/07/techtrends for all this and more.

BusinessWeek weekend

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the smallest screen offers big opportunities

Analysts community expects that about 100 million worldwide customers will use Mobile TV devices on several kind of devices by 2011. What was a \$50 million business in 2005 will be, in 2011, worth several hundred billion dollars.

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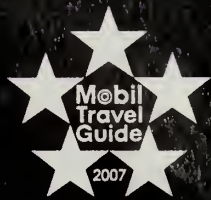
The Next Wave

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JP Front

"Piracy helped the young generation discover computers."

—Romanian President Traian Basescu to Microsoft Co-Founder Bill Gates on the role his company's pirated software played in helping Romania build a vibrant technology industry, as reported by Reuters.

ED BY DEBORAH STEAD



ANDS

Ford Goes Back to The Future

Ford's decision to rechristen what one of its top executives called "much-derided Ford Five Hundred '07" as a Ford Taurus may sound like marketing spin. But it's actually part of CEO Alan Mulally's program to purge the carmaker's wasteful ways. Ford stopped Taurus production in 2006 after a decade of declining sales and a year of relegating the model to rental and corporate fleets. In the last two years, it offered two new sedans, the Five Hundred and the Fusion. But they have yet to gain public name recognition, vs. 90%

for the Taurus. Ford spent more than \$1 billion advertising the Taurus. Canceling it "wasted 20 years of investment in a brand name," Mulally told *BusinessWeek* in December, when he was considering resurrecting the Taurus (fresh from a business trip for which he'd rented one).

When it debuted in 1985, the car had a breakthrough design, with softened corners that departed sharply from most sedans' "flying brick" look. A freshening in 1992 rescued slipping sales and kept the model on *Car and Driver's* 10 Best Cars list. But a 1995 makeover inspired

by Ford's oval logo flopped. Round edges gave way to a blobby, egg-shaped car dubbed the "bloated seal" by *Motor Trend*. **Toyota** Camrys outsold Tauruses.

Style may be an issue again. Ford has added a new grille and a peppier 3.5-liter engine to the 2008 Five Hundred-slash-Taurus. But the Five Hundred has been dinged for its bulbous shape—a design meant to give baby boomers with widening waistlines and waning flexibility more room. Last year, **Volkswagen** renamed its flagging Golf hatchback the Rabbit, the name the car had in the 1970s, and sales jumped 89%. Ford will be happy if its revitalized bull runs half as fast.

—David Kiley

ALL PHONES GO-TO DAYS FOR WINDOWS MOBILE THE GO

AFTER YEARS of struggling in the mobile market, **Microsoft** finally may be making a breakthrough. In January, according to research by IDC, mobile carriers worldwide sold more Windows Mobile-equipped phones than BlackBerry devices. A handful of slick new phones created for the Windows Mobile, including Motorola's slim Q and the

rounder Dash made by Taiwan's **HTC**, have helped the software giant. And *BusinessWeek* has learned that **LG Electronics**, the world's fourth-largest mobile-phone maker, is developing new Windows Mobile phones slated for launch this year. That means Microsoft will have three of the top five handset makers in its camp.

IDC's estimates of 2006 global market share for mobile phones with e-mail and Web access puts Microsoft's share at 9.8%. BlackBerry devices pioneered by **Research in Motion** came in at 7.3%.



9.8%
WINDOWS
MOBILE

WORLDWIDE SHARE
OF SMART PHONES
SHIPPED IN 2006



7.3%
BLACKBERRY
OS

RIM Chairman and co-CEO Jim Balsillie disputes those figures, asserting that proprietary data show that BlackBerry's worldwide share still tops phones running Windows Mobile. (He declined to provide numbers.)

Granted, BlackBerry held the U.S. lead in 2006's first nine months, with a 49% share, vs. Windows Mobile's 29%. And worldwide, both trail **Nokia-backed Symbian**, which is huge in Europe and Japan. But with LG on board, Windows Mobile's days as an also-ran may be over.

—Jay Greene

ORDER UP



YOU WON'T WANT FRIES WITH THAT

Americans are being drawn to Japanese fast food for much the same reason they like Japanese cars: The deals are good, and the products seem better than what some American rivals dish up.

Sales at Japanese and other Asian-fare chains jumped 15% to 20% in 2006, compared with 6% growth for quick-serve chains overall.

"There's absolutely potential for more growth," says Darren Tristano, executive VP of Technomic, a Chicago restaurant consultancy.

Yoshinoya, a Tokyo-based fast-food company with more than 80 California outlets, plans to double that number by 2010. Hibachi-San Japanese Grill, a fast-food unit of Panda Restaurant Group in Rosemead, Calif., plans to add a half-dozen sites this year to its 27 restaurants in 13 states.

Japanese food is seen as a low-fat fast-food choice, industry experts say. And younger consumers, who eat ramen (and Asian salads at McDonald's), find the food appealing. Not to mention cheap: At Yoshinoya, a bowl of grilled beef or chicken with steamed rice costs \$3.07.

—Michael Arndt

SPORTS BIZ

LE FOOTBALL GETS SOME NEW PLAYERS

INVESTORS are finally invading the soccer fields of France. The country's top-ranked **Olympique Lyonnais** team will be listed on the Paris bourse this month—the country's first club to go public. While teams elsewhere on the Continent and in Britain have floated shares, France had long prohibited such listings, saying smaller clubs would be at a disadvantage in attracting investors. But European Union regulators recently ordered an end to the ban, calling it a "barrier to the free movement of capital."

Olympique Lyonnais,

the national champion for the past five seasons, hopes to raise \$130 million to help finance a new stadium and to develop merchandising.

Investors may be feeling cautious, though. The Dow Jones STOXX football index of 27 European clubs is down 3% since 2002. Recently, after shares of Germany's **Borussia Dortmund** team tumbled 76%, a hedge fund bought a major stake in the club and is trying to turn it around.

Deep-pocketed new owners may be the best hope for troubled clubs. Even as Olympique Lyonnais prepares its IPO, nearby Olympique de Marseille is

GOAL
The team hopes to raise \$130 million for its IPO.



being sold to Jack Kachka, a Canadian pharma tycoon, for \$148 million.

—Carol Matlack



MERC WATCH WINDY CITY, FAIR-WEATHER TRADERS

IN A STUDY entitled *Gone with the Wind*, three finance professors from **Texas Christian University** and Bangkok's **Chulalongkorn University** found that windy conditions have a measurable effect on **Chicago Mercantile Exchange** futures traders. The study looked at 354 S&P 500 index futures traders judged to be "highly active." It examined the

traders' transaction records* from 1997 through 2001, matching them with **National Oceanic & Atmospheric Administration** weather data for Chicago.

Gusty mornings tended to correlate with a poor day of trading, the study found. On calm days, income from trades was higher. Researcher Peter Locke, associate finance

professor at TCU's Neeley School of Business, says he's not sure why. But he notes that elsewhere in the scientific literature, strong wind is linked to fatigue, headaches, and irritability. Thus, some traders who step out for lunch or a smoke, he theorizes, may "lose their concentration."

blustery weather. (He says the study controlled for variables like market return, daily trading volume, and time of year.) The research is just the latest in a string of studies looking at the weather's effect on markets, with earlier papers probing the influence of sunshine, the lunar cycle, and geomagnetic storms.

—Elizabeth Warren

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KEEP THE
FOCUS
ON THEIR CUSTOMERS?
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BRANCHING OUT BRANSON BANKS ON STEM CELLS

SIR RICHARD

Branson's **Virgin Group** encompasses planes, trains, spaceships, and comic books. And now, stem cell storage. On Feb. 1 the British entrepreneur launched **Virgin Health Bank**, a venture with London investment firm Merlin Biosciences. The bank preserves stem cells from umbilical cord blood, and Branson says Virgin's 50% profit share will support cord-blood stem cell research. "I'm absolutely passionate about the possibilities of stem



cells," he says. "I'd like to make sure the future benefits are open to everyone."

Free of the controversy surrounding stem cells drawn from discarded

embryos, cord blood stem cells have been used for years to treat some 75 blood and immune system disorders.

With a shortage of publicly available cord stem cells, Virgin Health points out that it goes beyond private service. It charges about \$3,000 for 20-year storage but splits each sample, with 20% kept for the family and 80% deposited for use by anyone worldwide at no charge. Besides goodwill, the bank may give Virgin added credibility as it moves into other high-tech areas such as biofuels.

—Kerry Capell



GAME PLAN

PASS GO. COLLECT \$200. HURRY!

IT HAS FEATURED different cities, pro teams, and p along with solid gold pieces and chocolate houses. But one version of Monopoly has been missing all these years: the kind you can play in 20 minutes. Now Hasbro is rolling out variations designed for the time pressed. **Monopoly Express** (\$13) eliminates money and has players accumulate properties with a roll of the dice. **Monopoly Electronic Banking** (\$35) speeds play by substituting an ATM-like card for cash. Phil Jackson, head of Hasbro's games unit, says research showed that people got bored with Monopoly's protracted endgame. Not everyone, of course. Says Stephanie Oppenheim, publisher of consumer guide *Oppenheim Toy Portfolio*: "Monopoly should take forever—until someone cheats or throws the board

—Christopher Palmer

BLOGSPOTTING MISMANAGEMENT

www.hrheroblogs.com

» **WHAT IF THE** droll antics on NBC's *The Office* occurred in real life? Bumbling branch manager Michael Scott (Steve Carell) would constantly be in court, says Julie Elgar, an employment lawyer who mines the sitcom for legal issues. Elgar's blog, "That's What She Said," is part of an HR site run by M. Lee Smith Publishers, and it's devoted to imagining the lawsuits that would arise if a real company were run like the fictional Scranton (Pa.) office. Writing about a recent episode, Elgar merrily calculates the cost of an on-site bachelor party with stripper. "Litigation value: \$800,000+."

—Lindsey Gerdes



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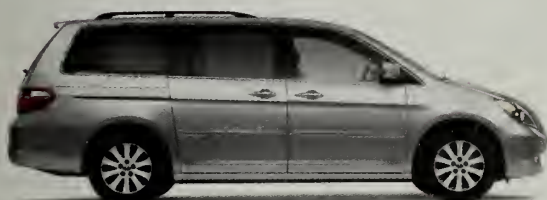
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JAPANESE BANKS READING YOUR PALM FOR CASH

WHEN JAPANESE consumers need lots of cash in a hurry, they go to their banks and raise their right hands—their palms or their index fingers, more precisely.

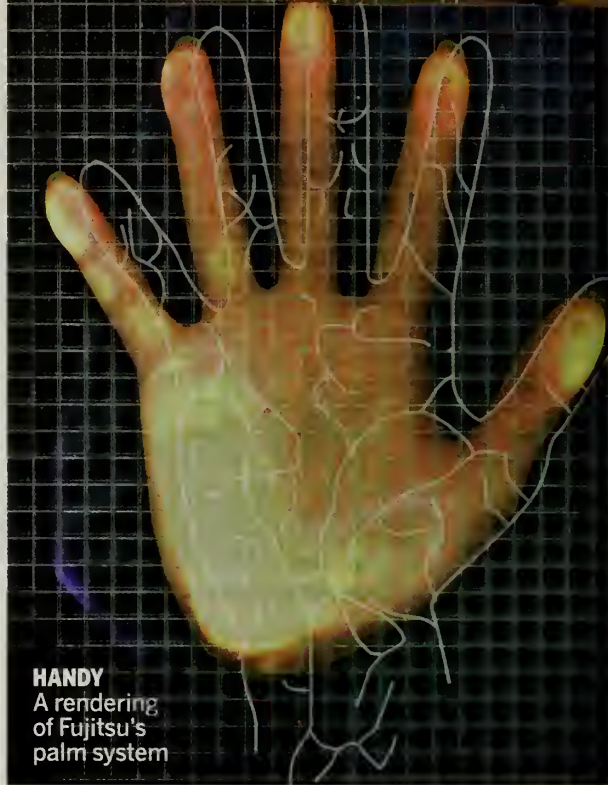
ATMs at many banks in Japan now have scanners that take a snapshot of the veins in a customer's finger or palm, then compare that picture against a digital image stored on the account holder's bank card. The extra high-tech step allows customers to withdraw the equivalent of tens of thousands of dollars at a time from accounts.

Over the past two years, dozens of financial houses have added the biometric security systems to their ATMs in response to legislation passed in 2006 that holds banks liable for ATM withdrawals made with stolen or counterfeit bank

cards. Customers have a few complaints: The scanners can't get a reading in bright light, they say, or when one's forefinger is even slightly curled away from the screen. But for most, the extra cash overshadows the extra hassle.

By now, some 20,000 of Japan's 110,000 ATMs have vein scanners, with sales of the technology at \$70 million, according to the Japan Automatic Identification Systems Assn., an industry trade group. Not bad for a business that practically didn't exist three years ago.

Will high-tech palm reading come to American banks? Some bankers and ATM makers have looked into the idea, but there are problems. The systems are expensive to install. And security consultants like Chris McGoe of Los Angeles-based McGoe Security Consulting worry that higher withdrawal limits



HANDY
A rendering
of Fujitsu's
palm system

would make ATM robberies more attractive. Perhaps more important, a format war is shaping up in Japan between two versions of the security technology—one that is likely to slow its adoption abroad.

The two incompatible technologies are **Fujitsu's** (which scans palm veins) and **Hitachi's** (which reads finger veins). Because most bank cards still have a magnetic strip that works at any ATM for lower withdrawal limits, the format rivalry has had

few casualties. But with banks considering phasing out the strips, that may change. "We're hoping the one we chose will become the standard," says Teisuke Kitayama, financial president of **Sumitomo Mitsui**, which uses Hitachi's system. So far, Hitachi appears to have the lead. Besides Sumitomo Mitsui, its customers include **Mizuho Financial Group** and Japan's soon-to-be-private postal system, which also runs a bank with 117 million customers. —Kenji

QUESTION OF THE WEEK

A new U.N. report on global warming states with 90% certainty that human activity is the culprit. As a skeptic about policies to cut CO₂ emissions, what's your response?

"The report had nothing to lead me to change my view that global warming cannot, at this stage, be distinguished from natural, unforced internal variability. These 'certainties' are bogus."

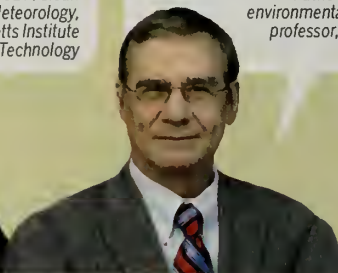
Richard Lindzen, Alfred P. Sloan Professor of Meteorology, Massachusetts Institute of Technology

"Saying that humans have a significant role in the warming is like saying there's gambling in Las Vegas. What can you do about it? A lot of politically possible solutions will do less than nothing."

Patrick Michaels, environmental sciences professor, University of Virginia

"Yes, humans have caused the earth to be slightly warmer, but much less than the report says. Many natural forces are not accounted for. I'd make a big bet that in the next 5 to 10 years the globe will start to cool."

William Gray, emeritus professor of atmospheric science, Colorado State University





The **CFO** needs to reduce costs.

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ReadersReport

“The goal of...publicly traded corporations is to grow in perpetuity. Where does that leave us on our finite planet?”

—Jeff Milchen
Bozeman, Mont.



ECO-CONSCIOUS COMPANIES: IRRELEVANT OR INEVITABLE?

“BEYOND THE GREEN corporation” (Cover Story, Jan. 29) presents a rather optimistic assessment of the business importance of corporate social responsibility. As the article notes, academic studies have not been able to prove a direct relationship between CSR and corporate financial performance, most likely because there is none.

Ethical investment funds continue to perform no better or worse than those based on other investment strategies. For virtually all companies almost all of the time, their CSR performance, whether leading or laggard, is irrelevant to their financial performance.

Numerous companies have “done good” but not well. This unfortunately long list includes Interface, Levi Strauss, Gap, Body Shop, Ben & Jerry’s, Chiquita Brands, and now Home Depot. Until very recently it would also have included Marks & Spencer and Hewlett-Packard, two of the businesses featured in the story’s list of those (now) “doing well by doing good” but that recently had experienced serious financial problems. The poor performance of these outfits was not due to their being too responsible, but neither was their leadership role in CSR sufficient to compensate for other management failures. The market has many virtues, but rewarding more responsible companies and punishing less responsible competitors is not among them.

—David Vogel
Haas School of Business
University of California at Berkeley
Berkeley, Calif.

THE BUSINESS MODELS of some corporations cited in your story are antithetical to sustainability.

Decreasing fat in fast-food burgers may aid the health of their customers, but spreading Wendy’s and McDonald’s incredibly resource-intensive diet of fac-

tory-farm-produced meat to people presently eating grain-based diets is irreparably damaging to our planet. And improvements to fuel efficiency or “green building” by Target or Wal-Mart Stores can compensate for the inherently destructive model of shipping most goods across the globe.

The goal of these publicly traded corporations is to grow in perpetuity. Where does that leave us on our finite planet?

—Jeff Milchen
Bozeman, Mont.

AS A MANUFACTURER of organic rice tea, we’re in the arena with other companies using good farming practices, pursuing pesticide-free agriculture, raising hormone-free livestock.

Recently, however, we decided that organic certification didn’t go far enough. We took greater control of our supply chain and changed the source of our main ingredient, yerba maté tea, to a farm that is fourth-generation family-owned and Fair Trade, which means workers in Argentina are paid a living wage for their work harvesting our tea. While our commitment to sustain Fair Trade farming is good public relations, we’re now finding that our supplier is more stable, more responsive and more ethical in its dealings with us and our product. Switching was originally a point of great debate in our company. Now it’s obvious that the benefits in terms of image and efficiency far outweigh the incremental cost per pound of the maté—and it is the right thing to do.

—Thomas Wollmann
Bombilla & Goura
Englewood, Colo.

WHETHER THE CURRENT drive toward corporate sustainability is genuine or mere public relations, the fact remains that, in the long run, sustainability must not merely exist as an option: It will must become an investor-driven as-

physical necessity. The human moperandi is inherently shortsighted, overemphasizing the immediate, is countless indicators have recently onstrated, issues of sustainability become very much concerns of the and now. It is only a matter of time re these concerns garner the scru- of the investing public.

The earth itself is an asset, and ting at the expense of this resource out accounting for its deprecia- is not a practice that can continue ecked. The present scale and scope ndustry has left an ominous envi- mental footprint, and only the most gant of companies could be reckless gh to believe investors will ignore equences that now loom just over orizon.

—Ari David Kopolovic
Cambridgeshire, England

R ARTICLE CORRECTLY points hat companies need to wean their ucts from toxic materials lest such ucts get shut out by the tightened lations of European markets. But pe is just one driver of corporate -chemicals policies. Many states he U.S. are also outlawing spe- chemicals for use in products and

are adopting environmentally prefer- able purchasing practices. Additionally, many private-sector companies are im- plementing such practices, shutting out dirty products and creating opportuni- ties for innovative cleaner ones.

—Richard A. Liroff
Investor Environmental Health Network
Arlington, Va.

ADVERTISERS CAN'T AFFORD TO IGNORE AGING BOOMERS

"FAR FROM HALLMARK'S best mo- ment" (Entertainment, Jan. 29) stated that the median age of the Hallmark Channel's audience is 60, "hardly the demographic advertisers crave." Given the country's more than 78 million baby boomers and their estimated \$2 trillion in buying power, according to AARP, perhaps advertisers need to rethink their targets.

My cohorts buy pricey cosmetics, go hiking, and spend lots of money on our leisure pursuits. And those devices at- tached to our ears? They're iPods, not hearing aids. If the Hallmark Channel is "one of the most-watched offerings on cable," yet it brings in relatively few advertising dollars, then the remedy is to court advertisers who give boomers what we really want, not what someone

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...ks we want based on an outdated
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IN THE HEALTH-CARE SYSTEM DERS ENTREPRENEURSHIP

LD HOSTAGE BY health care”
ial Issues, Jan. 29) misses the larger
it. It's not just workers, it's the econo-
that is held hostage by health care.
“Job lock” is the tip of the iceberg.
rowth lock” is on the horizon if we
t make affordable health care avail-
to every American—and not just the
r or children. I'm referring to aging
mers who decide to leave corporate
to start a business, as I recently did.
hose in the 55-to-64-year-old demo-
hic are most likely to start a company.
when we do, it becomes a game of
ble jeopardy. We risk our savings on
venture, and we risk being told we're
gible for individual health insurance if
r our spouses become seriously ill.
resident George W. Bush and others
e proposed ways to make health care
e affordable through tax breaks and
r means. But tax incentives will not
e health care more accessible. As long
managed-care companies can deny in-
duals coverage based on past or future
ical conditions, those who could start
ures, build products, create jobs, and
st the economy will sit tight, locked
their dead-end jobs for fear of becom-
insurable before Medicare kicks in.

—David C. Loveland
Wilmette, Ill.

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...e photo of Julie Roehm on page 74 of
...y year at Wal-Mart” (People, Feb. 12)
...ould have been credited to Santa Fabio.

Beyond the green corporation”
pecial Report, Jan. 29) said Shahreza
sof of Aberdeen Asset Management PLC
ted PetroChina Co. “a buy.” Aberdeen, an
ernational investment management
oup, does not issue stock ratings and
es not hold PetroChina in its socially
sponsible investing portfolios.
usinessWeek did not interview Yusof, but
sinterpreted comments by him posted
MarketWatch.

ello, you must be going” (News & Insights,
b 12) should have said Joseph V. Tripodi
und himself unhappy almost immediately
er taking a new marketing job at Bank of
ew York, not Bank of America Corp.

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Mischief-Proofing Your PC

In promoting Windows Vista, Microsoft says its new operating system will help you have “a PC protected from viruses, worms, [and] spyware. Alas, this statement is only partly true. Despite security improvements, Vista users, like those with Windows XP, need to run additional software to keep their PCs healthy and safe. ¶ All operating systems—yes, even

Apple’s Mac OS X—have vulnerabilities. Moreover, the nature of the threat keeps changing. Instead of coming from maladjusted kids trying to make a point, security experts believe that most attacks these days are financially motivated efforts to steal data or take control of machines. And the old classification of threats as spyware, viruses, or worms has lost meaning as computer attacks have become multifaceted.

One consequence is that it no longer makes much sense to think in terms of a firewall to stop network intrusions, antispyware software to stop installations of nefarious software, and virus protection to block worms and viruses. Today’s blended threats call for a more comprehensive approach.

Vista comes with only some of the necessary tools. The major addition in Vista is Windows Defender, an antispyware program with no antivirus features. And contrary to what I wrote in a Jan. 22 column based on information Microsoft provided, the Vista firewall is not configured to stop so-called Trojan horses—unauthorized programs that transmit information from your PC. In fact, it’s almost impossible for average users to set up the firewall to do that.

I THINK YOUR BEST BET, whether you’re using Windows Vista or XP, is an integrated package that combines spyware and virus protection with a firewall that watches both inbound and outbound network traffic. (Macs come with a decent firewall and have not been targeted by spyware, so users can get by with just an antivirus product.) Security software companies such as firewall maker Zone Labs and spyware specialist Webroot Software are scrambling to assemble integrated suites, but so far their efforts have felt either stapled together or incomplete. The latest version of Webroot’s Spy Sweeper, for example, adds virus protection but lacks a firewall. The bigger players—Symantec, McAfee, and a newcomer to this field, Microsoft—offer users a much better experience. I tried Symantec’s Norton Internet Security 2007 (\$70), McAfee



Vista comes with only some of the protection you’ll need

Internet Security Suite 2007 (\$50) and Microsoft OneCare (\$50). A run on Vista or XP, include a year of updates, and can be used on up to three computers.

In my tests, Norton emerged as the winner. It was the best at doing its job unobtrusively. It was the only one that didn’t pop up to ask obvious questions, such as whether a Web browser should be allowed to access the Internet. Norton did it brag, like a cat dragging in a dead bird, about the threats it had stopped. It has also corrected a problem in earlier versions of Norton firewall, which blocked a lot of safe uses. McAfee also did a fine job, but it made a lot more noise in the process.

OneCare goes further than either of the others, adding data backup and performance tune-ups. (Norton 360, currently in a testing phase, will add similar features, as will the \$70 McAfee

Total Protection.) I found OneCare’s performance and ease of use about equal to McAfee’s, but I’m a bit nervous buying protection from the company that created the problems.

Test labs rate these programs based mainly on how quickly they respond to new threats. I’m not convinced that’s important, since at any given time the newest threats account for only a tiny fraction of attacks. The important thing is to install the software, maintain the annual subscription, and make sure the program updates itself automatically. ■

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What Makes 'Citizen Ads' Work

This column requires ground rules in order to avoid hurting your eyeballs. Therefore, instead of the excruciating “consumer-generated advertising” and “consumer-generated marketing,” I will use “citizen advertising” and “citizen marketing.” In varying ways, all manner of companies solicit or encourage such efforts on the Web. As evidenced by two highly publicized

Doritos ads that ran during the Super Bowl, these efforts sometimes cross media platforms to show up on TV screens.

The arguments for citizen ads encompass every current marketing cliché. A company invites consumers to submit ads to its Web site, which means said consumers spend much time thinking about the product (marketing cliché alert: engagement, interacting with the brand). These ads are shown online to let the public chatter and vote on which is best (cliché alert: community). That the ads come from the vox-pop ensures they are (cliché alert) authentic. With luck, what consumers submit is good enough to stand out from the omnipresent ambient marketing noise (cliché alert: breaking through the clutter). And good enough so people come back to the site for more. Also, lest we forget: Letting consumers do the work is cheap. While citizens' efforts are nascent, making it impossible to know how effective they are long-term, early blog buzz on Doritos' Super Bowl ads is easily as positive as what some traditional ads elicited.

Not every company has wild-eyed devotees. So thus far, citizen ads mostly push products that people adore—Chevy asked fans to submit ideas for its Super Bowl spot—or those that target young men, like Doritos. The people who create them have already joined the fan club and bought the T-shirt (or they're so rabid they make their own). There's a reason why the National Football League asked fans to submit Super Bowl ad ideas. Football freaks get very geeked-out about their sport, as do those who post homemade Apple ads to YouTube.

AND THERE'S A REASON WHY CLOROX HASN'T asked for ideas. Many big advertisers sell commodities—soap powder, paper goods—that lack logos people tattoo on their torsos or paint on their faces. Many big budgets push products with very specific demands. For example, yogurt maker Dannon's marketing strategy dictates that ads must help



PRODUCT PASSION is the reason Doritos' Super Bowl ads clicked



maintain consistent demand for perishable product. Yogurt is “I and active,” says Chief Marketing Officer Andreas Ostermayr. “We cannot keep huge stocks of it.” fears that citizen ads will elicit a “less predictable” response from consumers.

Wary, too, are some top ad executives. “We are pros, and although it looks easy to create advertising, it isn't,” writes Wayne Best, executive creative director of New York boutique agency TAXI, in an e-mail. “User-generated content reminds me that there's a reason I have a job.” But I have little patience for arguments equating “pro” with “better.” History is full of examples where “pro” turns out to be an artificial construct. (The music and film indie revolutions of the '80s taught us there was more and better talent than the major labels and studios would have had us believe.) Without all the hype, I doubt viewers would have known Doritos' ads were not made by an agency.

Many companies that hire ad firms get this. (“Agencies beware,” exulted a Sony executive in *Advertising Age*, in discussing one citizen ad contest.) What they don't get is that not every product engenders fanaticism: I spent much time on the phone last week arguing with marketers about whether or not consumers get excited about soap. I should sporting and point out that in places where citizen ads may not work, citizen marketing may well. In 2001, Johnson & Johnson bought babycenter.com, a wildly popular community site for new parents. J&J opted, in other words, not to build a site about baby powder. Detergent buyers might not make ads for fun like Apple freaks do. Hanging out at a market getitclean.com site? Well, that's a whole other story. ■

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For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia

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JAMES C. COOPER

Business is Still In An Expansive Mood

Capital spending, a powerful growth engine, looks set to rebound

U.S. ECONOMY American businesses got a bad case of the jitters last year. You can't blame them: Oil shot above \$70 per barrel and seemed to be on its way to \$80. Housing fell into a recession with much fretting over a broader downturn in the economy, and the Democrats took over Congress, creating a new uncertainty over the

economic policy was headed. Business confidence buckled and, by yearend, worries about the future had translated into an outright decline in capital spending, the first quarterly drop in almost four years. Working amid the positive surprises in the government's fourth-quarter report on economic growth, which showed real gross domestic product increasing at a strong 3.5% annual rate, was an unexpected 0.4% drop in business investment in new machinery and equipment. Spending on equipment and software dropped 6%, while construction outlays grew only 2.8%, the slowest pace in five quarters.

All this sets up a crucial question for the 2007 outlook: Can businesses venture out of their foxholes? More specifically, can we count on outlays earmarked for replacement, expansion, and innovation to play their traditional important role as engines of growth?

Based on the underlying factors that typically drive capital spending, there is every reason to believe last year's slowdown was not the beginning of a lasting setback that could crimp the economy's prospects. In fact, capital spending is likely to speed up again in coming months and be a growth leader for 2007. The list of supports already in place is long: The most important, demand, remains strong both at home and abroad. Capacity use is already at a high level. Profits are still making healthy gains. Corporate balance sheets are in great shape, and financial conditions remain accommodating. At the end of last year, CEO confidence edged up a bit, and capital-goods orders rebounded, as did output of business equipment. Even oil prices, while edged back up by winter's chill, are still down to where they were this time last year.

BUSINESSES WERE CONCERNED about the housing slump putting a damper on demand, last quarter's report buried that notion once and for all. The importance of the GDP data for capital spending was so much the economy's surprisingly strong overall growth rate but the speedup in total demand for goods and services, which grew at a 4.2% annual rate. That gain is especially impressive because it occurred amid a

19.2% plunge in outlays for residential construction.

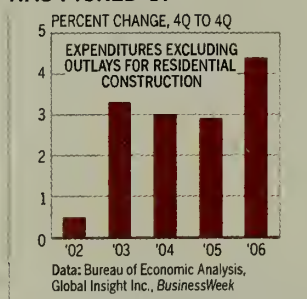
Most notably, real consumer spending grew at a 4.4% rate. Except for the 4.8% gain in the first quarter of last year, that was the strongest quarter for consumers in almost three years. Foreigners weren't shy about spending, either: Real exports jumped 10%. Overall, outside of the housing slump, demand in 95% of all spending categories was up 4.4% from a year ago, the fastest annual advance in almost seven years (chart).

CONSUMERS REMAIN ROCK STEADY not just because of lower fuel prices. Yes, cheaper gas and heating oil helped to boost buying power, so fewer outlays for gas meant more income could go for other things. But spending on items other than energy and food also accelerated last quarter, in terms of both actual dollars

spent and after adjusting for inflation.

The more important lift is coming from strong labor markets and income growth. Despite the slower pace of job growth in January, there are few signs that businesses are cutting back their payrolls. That's a positive sign for capital spending because the growth rates

WHERE DEMAND HAS PICKED UP



of hiring and business outlays are highly correlated.

Payrolls rose by 111,000 workers last month, less than in recent months, but given the Labor Dept.'s recent penchant for revising their initial estimates upward, the smaller-than-expected January gain should be taken with a grain of salt. Labor subsequently lifted the November and December job gains by a total of 81,000.

That's not the half of it. The Labor Dept.'s annual benchmark revisions added 754,000 new jobs from March, 2005, to March, 2006, and Labor raised its earlier numbers on payrolls from March, 2006, to December, 2006, by 179,000. The bottom line: Before these

revisions, payrolls were thought to have grown by 3.3 million jobs from March, 2005, to December, 2006; after a second look, job growth turned out to be 4.3 million. During 2006, incomes from wages and salaries rose 4.2% after adjusting for inflation, the strongest year since 2000. No wonder consumers have been so resilient.

MORE IMPORTANT for the corporate sector and its future spending, the economy is also generating plenty of profits. Last quarter's drop-off in capital spending is both inconsistent with the vigor in hiring and runs against the strength in earnings. Profits drive capital spending, and earnings are holding up much better than most analysts expected.

Through Feb. 2, with 308 of the 500 companies in the Standard & Poor's 500-stock index having reported for the fourth quarter, earnings are on track to grow 10.4% from a year ago, based on Thomson Financial's blended growth rate, which combines actual reports with the current expectations of those companies yet to report. So far, 64% of companies are beating estimates, which is above the 60% typical for a given quarter.

Perhaps more significant is that the double-digit profit showing has been greatly reduced by the yearend plunge in oil prices, which narrowed the earnings of energy companies. Excluding the energy sector, Thomson says profits in the remaining nine sectors of the S&P 500 are up 14.5% (chart). And there is no sign that overall profit margins face any kind of severe squeeze. Margins appear to be holding close to the record levels posted through the third quarter of 2006. Given the river of internally

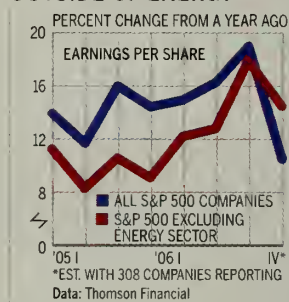
generated funds and readily available outside credit, corporate financing conditions are very supportive.

There were some signs at the end of last year that businesses were shedding their caution. In December new orders for capital goods (outside of the big ups and downs in the aircraft sector) rose a solid 3.1% after two

declines in a row; and production of business equipment posted a 1% gain, the strongest since last April.

Plans for new business construction in 2007 look solid, suggesting the yearend slowdown in new-facility outlays does not presage more softness. Prior to last quarter's slowdown, outlays for business

PROFITS: STILL STRONG OUTSIDE OF ENERGY



construction had grown 14.1% per quarter during the previous year. For 2007, growth is expected to match the 2006 pace, according to the American Institute of Architects' panel of forecasters, with strength concentrated in offices, hotels, and health-care facilities.

Given a healthy economy, high rates of return on new projects, the excellent financial condition of the corporate sector, and the low cost of capital, businesses have every reason to take advantage of growth opportunities in 2007. So look for companies to move forward with the expansion plans at a faster rate as the year progresses.

PRODUCTIVITY

The Housing Drag Casts a Long Shadow

DURING 2006, productivity growth was the weakest in nine years, while the labor cost required to produce a given unit of a good or service surged. But don't fret too much: The data on productivity and unit labor costs are being skewed by the housing downturn.

Investment in residential construction plunged in the fourth quarter, posting an annualized decline of 19.2%, the biggest quarterly contraction since 1991. What's more, the housing recession knocked a quarter-percentage point off economic growth in 2006, even though residential investment accounts for less than 5% of the economy. Meanwhile,

residential construction and specialty contractor payrolls declined by just 1.4%, or 47,300 workers, in 2006.

The resulting drop in output per worker in residential construction weighed heavily on the productivity data. The Bureau of Labor Statistics reported nonfarm labor productivity rose 2.1% in 2006; homebuilding pulled that growth rate down by

about two-thirds of a percentage point, says Steven Wieting, an economist at Citigroup. And since homebuilders handed out few pink slips as construction activity fell, unit labor costs climbed. Rather than signaling surging wage pressures, though, higher unit costs

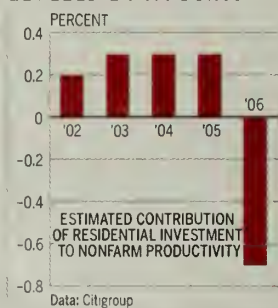
reflect the same amount of labor building fewer houses.

All this is about to change. Residential construction payrolls don't begin to decline until after the number of housing completions starts dropping, which began in the second half of 2006. "The layoffs are going to come," says Wieting, who estimates that job cuts in housing could top 500,000 during 2007. What's more, the declines in residential homebuilding are expected to dissipate. The combination means "productivity measures could rebound measurably over the course of 2007," says Wieting.

A return to stronger productivity and slower unit labor costs would help to reassure economists that the long-running productivity boom is still intact and ease any worries about future inflation. ■

—By James Mehring in New

PRODUCTIVITY GROWTH LEVELED BY HOUSING





**What do you call a year in which you sell 63 million
Earth-friendly products? A healthy start.**

The Home Depot® is committed to home improvement, including the home we call Earth. We started this initiative in 1990 and brought our vendor partners aboard. Together, we offer customers a wide range of eco-savvy options. Last year, sales of ENERGY STAR® qualified products increased by 25%. And the energy saved by the compact fluorescent lightbulbs we've sold could light the homes in Washington, D.C., for three and a half years. All of which lets us know that we're on the right path. For our people. For our communities. For our planet.



The Business Week

News you need to know

EDITED BY HARRY MAURER



Budget Battles Ahead President George W. Bush (above, with Treasury Secretary Henry Paulson Jr.) dropped his record \$2.9 trillion fiscal year 2008 budget on Capitol Hill with a thud on Feb. 5. The plan proposes to steer more funds to defense contractors like **Northrop Grumman** and **General Dynamics** while cutting subsidies to farmers and higher-education lenders like **Sallie Mae**.

Like all Presidential budgets, this one is a political document no one expects to play out in its current form. It eliminates the deficit by 2012, in part by banking \$499 billion in **Alternative Minimum Tax** revenue, which may or may not materialize. Congress has tinkered with the AMT, which was originally aimed at the wealthiest Americans but now hits the middle class and small businesses, with one-year patches that shield some taxpayers. The budget assumes that Congress won't extend the fixes past 2007, and that 26.5 million taxpayers will pay the AMT next year—up from 3.5 million last year.

ONLINE See “A budget with rose-colored glasses,” www.businessweek.com/go/tbw

Blackstone Wins Paper beats rock. And cash trumps stock. Shareholders of **Equity Office Properties** approved on Feb. 7 an all-cash takeover by the **Blackstone Group** valued at \$39 billion including debt: the biggest private-equity purchase ever. The deal for the nation's No. 1 office landlord was cinched after **Vornado Realty Trust** gave up on its \$56-a-share cash-and-stock bid. Although Vornado's offer was higher than Blackstone's \$55.50-a-share proposal, Equity Office preferred the sure thing of cash on the barrelhead.

Can Kodak Print Money? Longtime Hewlett-Packard executive **Antonio Perez** lost out in the CEO sweepstakes to **Carly Fiorina** in 1999. Now, as boss of **Eastman Kodak**, trying to create a facsimile of HP's profitable printing imaging group. On Feb. 6 he plunged Kodak into the summer inkjet printing business with a new wrinkle: replacement cartridges that retail at half the price consumers typically pay. Revenge? Perez says it's just good business.

See “Kodak's moment of truth?” page 42, **ONLINE** “Kodak launches a printer offensive,” www.businessweek.com/go/

Sleuthing on the Street Are some Wall Street firms giving hedge fund customers a leg up? *The New York Times* reported on Feb. 6 that the **SEC** wants to know whether brokers are improperly tipping off hedge funds about big trades by institutional investors. A hedge fund with advance word can make hay because big trades can move a stock price. Regulators at the agency have asked 10 Wall Street houses to turn over trading information and other data. The SEC says it's too soon to say whether the inquiry will lead to any action.

Home Depot Makes Peace Frank Blake's extreme makeover of **Home Depot** continues. In early February the CEO ushered out a cadre of executives aligned with old boss **Bob Nardelli**. And, on Feb. 5, Blake defused a potential proxy battle with **Relational Investors**, an activist investment firm, by inviting Relational exec **David Batchelder** to the Home Depot board. The question remains whether Blake will follow Relational's other suggestions, which include selling the \$12 billion wholesale supply division.

NBC's New Boss The wunderkind has reached the top. To no one's surprise, **Jeff Zucker**, who became executive producer of the *Today* show at age 26, was named head of **NBC Universal** on Feb. 6.

See “Now Jeff Zucker must prove himself yet again,” page 43

Unhand Those Videos! MTV parent **Viacom** became the first media giant to order online sensation **YouTube** to take down its content, so on Feb. 2 the freebie site said it would yank more than 100,000 snippets of Viacom-owned TV fare. Sources say YouTube, acquired by **Google** last year for \$1.65 billion, has been offering media companies \$1 million a year for such rights. Viacom says it isn't close to a deal and until one is signed, it doesn't want YouTube pulling content from Viacom-made programs.

ONLINE See “Viacom's high-stakes duel with Google,” www.businessweek.com/go/

Hyundai's Black Eye On Feb. 5, **Hyundai Motor Chairman Chung Mong Koo** was hit with a three-year prison sentence for illegally raising some \$75 million for kickbacks, and costing the company more than \$200 million by transacting intragroup deals through affiliates. But even if he loses on appeal, he may not do any jail time because of South Korean law.

ea's leniency with convicted corporate bosses. His conviction and planned appeal are sure to further distract already bogged-down top managers: In the past year, Hyundai suffered a production loss of \$2 billion because of labor strife, a 0.2% fall in revenues, and a 34% profit plunge because of Korea's strong currency.

ONLINE See "Hyundai's true trial: Better performance," www.businessweek.com/go/tbw

Wal-Mart Watch *En garde, Steve:* In a move aimed squarely at Apple's iTunes service, Wal-Mart launched a test version of a video-downloading service on Feb. 6, becoming the first major retailer to have the backing of all Hollywood's big studios; iTunes (see related story below) is backed by only two. Wal-Mart's smorgasbord offers more than 13,000 movie and TV titles. In other Wal-Mart news, on Feb. 6, a federal appeals panel in San Francisco ruled that Wal-Mart's sex discrimination suit against the company that involves at least 1.5 million women could proceed as a class action. Wal-Mart says it'll appeal.

ONLINE See "Wal-Mart enters the movie download wars," www.businessweek.com/go/tbw

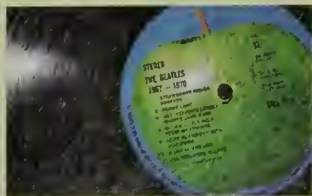
Low and High Chrysler has chopped 42,000 jobs since 2001, and it's not done yet. On Feb. 14 the carmaker expected to announce cuts of 10,000 jobs and at least 10 plant closures to deal with its red ink and falling market share. Juggernaut Toyota, on the other hand, reported record \$3.54 billion profit in the quarter ended Dec. 31, and figures to earn \$12.8 billion for the year ending in March.

ONLINE See "Chrysler: After the cuts, what next?" and "Toyota's engine vrooms on," www.businessweek.com/go/tbw

Long and Winding Road of the Week

There's a Beatles song for every occasion. Take 1965's *We Can Work It Out*: perfect for settling lawsuits, which is what the Fab Four's London company, Apple Corps, did with Apple Inc. of Cupertino, Calif. The Feb. 5 accord ends the third in a series of spats over the rights to the word "apple" and related logos. Having agreed to share the rights in 1980, they ended up in a London court in 2003 over the launch of the iTunes store. Cupertino now controls the Apple name, while Apple Corps will have licensing rights. It's still unclear when Beatles music will bow to iTunes. One thing that could delay it: On Feb. 6, Apple CEO Steve Jobs published a 1,800-word essay arguing that record companies should stop requiring copyright protection technology attached to songs sold online.

See "Steve Jobs changes his tune," page 64
ONLINE "The Apples come together" and "Steve Jobs' music manifesto," www.businessweek.com/go/tbw



APPLE CORPS CONTENT (VINYL)

Connectile Dysfunction (CD)

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CAPITAL

IT'S A LOW, LOW, LOW, LOW-RATE WORLD

Money is cheap. And some experts say it could stay that way for years. That's creating opportunity—and brand-new risks

BY MICHAEL MANDEL AND DAVID HENRY

WAIT A MINUTE—weren't long-term interest rates supposed to be a lot higher by now?

When the rate on the 10-year Treasury bond plunged from 6.5% in early 2000 to an average of 4% or so in 2003, the explanations were easy: tech bust, recession, weak capital spending, low inflation, steep rate cuts by central banks around the world. The low rates seemed perfectly normal—and sure to reverse on a dime when conditions changed.

Since then, plenty has changed. The Fed has hiked short-term rates by more than four percentage points. The global economy grew by 5.1% in 2006, the second-strongest performance in 25 years. Europe and Japan have recovered. Even tech spending seems to be on the rise,

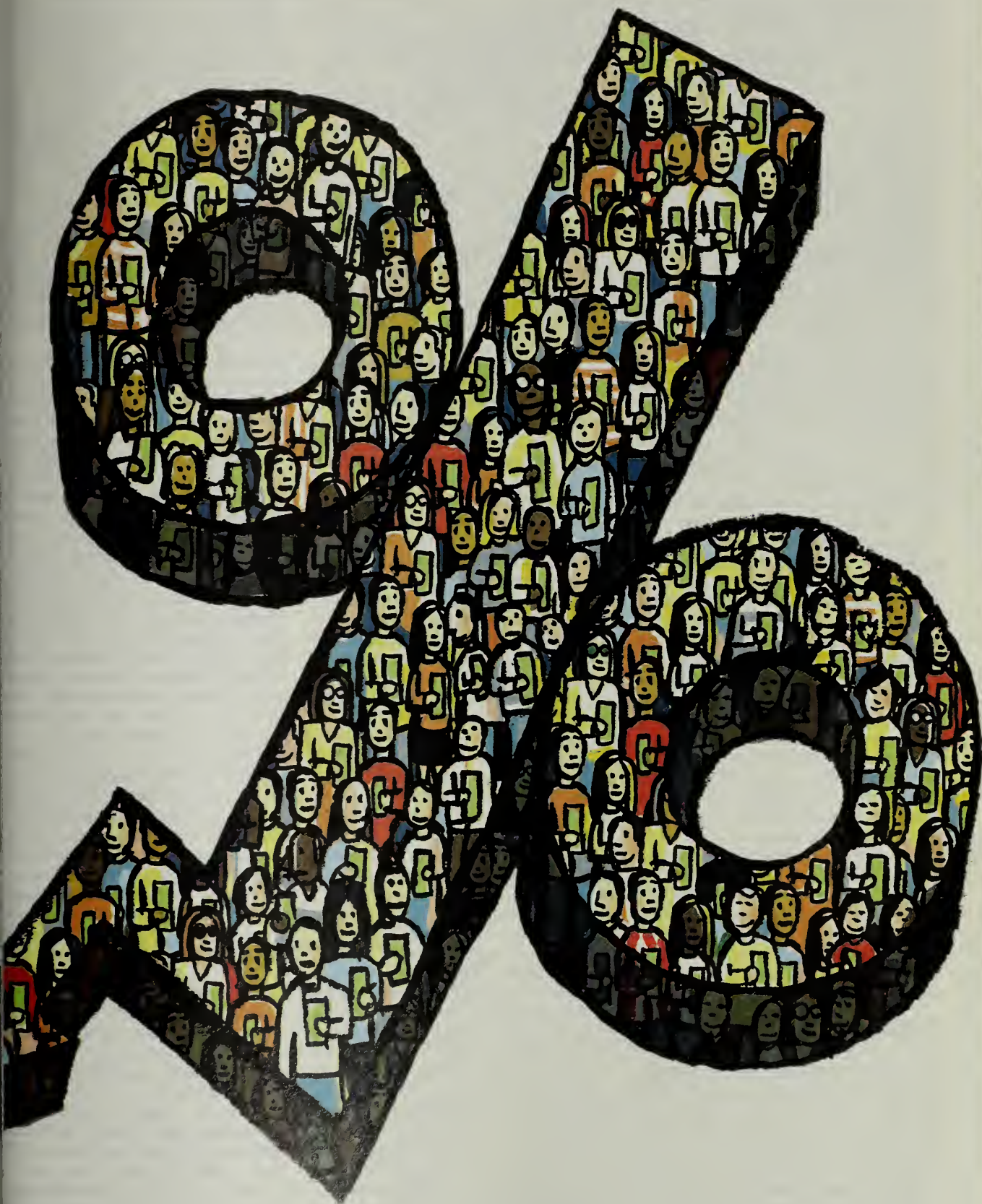
judging from Cisco Systems Inc.'s strong earnings report on Feb. 6. And yet—and yet!—10-year Treasury rates have risen only three-quarters of a percentage point. Real rates, which adjust for inflation, have barely budged.

It isn't only a U.S. phenomenon. Ten-year euro bonds are yielding around 4% today, no higher than in 2003, despite much faster growth in the region. Real rates in the euro zone are up only a bit.

Borrowers, of course, are deliriously happy. Even the shakiest companies are seeing their debt costs plunge. The spreads on triple-C rated bonds and lower—the junkiest of junk—are at a record low 4.7 percentage points over ultrasafe Treasuries, compared with the previous record of 5.2 percentage points in 1997, according to Merrill Lynch & Co.

Most remarkably, the craziness isn't likely to stop anytime soon. The low

ROBERT NEUBECKER



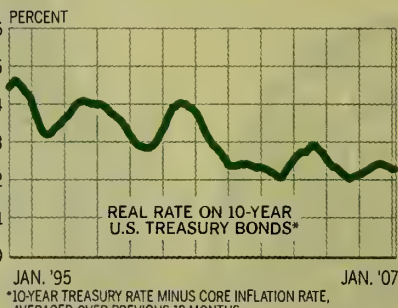
MORE EFFICIENT FINANCIAL MARKETS

Strong global growth...



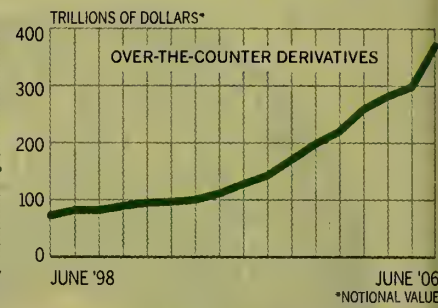
Data: IMF

...has come with falling capital costs...



*10-YEAR TREASURY RATE MINUS CORE INFLATION RATE, AVERAGED OVER PREVIOUS 12 MONTHS
Data: Federal Reserve, BusinessWeek

...and a wider use of derivatives to reduce credit risk



Data: Bank for International Settlements

cost of capital is probably going to last "five to seven years," says Samuel Zell, who as chairman of real estate firm Equity Office Properties Trust watched bidders wield cheap debt in a fight over his company. (Blackstone Group, with a \$39 billion bid, won out on Feb. 7.) James W. Paulsen, chief investment strategist at Wells Capital Management, sees an even longer horizon: "This could be a prolonged cycle where the cost of capital is low [for] 10 or 20 years."

It is, indeed, a low, low, low-rate world.

Easy money is creating all sorts of economic benefits. Corporations are making capital investments again—and with their borrowing costs so low, profits are still zooming. Private equity firms are using loads of cheap debt to buy companies at jaw-dropping prices. Even the housing market, which boomed for five years on cheap money, hasn't fallen apart. It's gliding to a soft landing rather than a hard crash, allowing consumers to keep spending (page 35). "We are in this era where financial innovation and product structuring, particularly in the debt markets, has been very stimulative," says Henry H. McVey, chief U.S. investment strategist at Morgan Stanley. Zell puts the state of rates in similar terms: "I think that's going to be a growth accelerator around the world."

'FUTURE TURBULENCE'

BUT THE EASY MONEY also brings a slew of unexpected problems. Historically, risky borrowers have had to pay much higher interest rates on their debt. Now there's little penalty—and that means there's less incentive for companies to stay fiscally sound. Low rates aside, other borrowing terms are getting easier, too. Many debt deals being made today have fewer protections for investors in case companies can't pay. "I've never seen issuers have this

much power," says Raymond G. Kennedy, a bond fund manager at PIMCO with 26 years' experience under his belt. Kingman D. Penniman, founder of KDP Investment Advisors Inc., a bond research firm, sees a dark side to this: "You're laying the groundwork for future turbulence."

The shift to a low-rate world doesn't mean lower volatility. In fact, excesses, crack-ups, and bad investments are not only possible but guaranteed. "Over the next several years there's likely to be some event that will widen out the spreads," says Zane Brown, director of fixed income at mutual fund manager Lord, Abnett & Co. But when the dust has cleared, he says, the world economy will likely be left with a lower cost of capital than the average over the past 5 to 10 years.

In some ways, it's the 1990s all over again. Back then, the info-tech boom created an unexpected boost in productivity that persists today. Now it looks like something analogous has hit the global financial markets. A combination of globalization, innovation, and good old-fashioned competition among markets has made it easier and cheaper to raise and deploy money. Borrowers now can draw funds from around the globe. And derivatives let financial institutions and traders manage their risks with mind-blowing precision. With Chicago, London, New York, and Frankfurt all jostling to be the world market leader, exchanges and financial institutions have an incentive to be cheaper, faster, more innovative (page 36).

At the same time, the low rates reflect major imbalances in the global financial system. The developed countries, led by the U.S., have systems that are good both

at raising money and allocating it. Emerging markets such as China have only half of that equation: They can collect money, but they don't have the financial institutions that can put it to the best use. According to a November, 2006, survey of executives by McKinsey & Co., 40% of respondents in China and Latin America said their company's access to external funding is good or very good.

Eventually the financial systems in China and India will improve, and a more of their capital will be used at home. That won't happen anytime soon, though. In a new book, *The Next Great Globalization*, Federal Reserve Governor Frederic S. Mishkin writes: "It takes a long time for any nation to achieve strong property

rights and an effective financial system."

For now, China and other emerging markets serve as key suppliers of capital in increasingly connected markets. "People are more willing to throw money across borders across currencies to get the highest yields," says Deborah A. Wyss, chief economist at Standard & Poor's. Indeed, in just the past year,

value of outstanding international securities—debt raised in foreign currencies or foreign currencies—has risen by 20%.

It's a continuation of a long-run trend. Since 1990, cross-border capital flows have been rising at a 10.7% annual rate, adjusted for inflation and exchange fluctuations, says a January, 2007, report from the McKinsey Global Institute. That's up from just 4.3% from 1980 to 1990.

An essential part of the globalization story is the adoption of the euro in 1999, which created a huge pool of highly mobile capital from lots of smaller po-

The shift to a low-rate world doesn't mean lower volatility

he euro markets are today much bigger than what they would be if we had the euro," says Jerry del Missier, president of London-headquartered investment bank Barclays Capital.

The second key factor is the development of new trading instruments. Financial innovation isn't new, of course. Mortgage-backed securities date to the 1970s, and junk bonds came to life in the 1980s. But innovation seems to have reached a fever pitch with the recent advances in collateralized debt obligations (CDOs), which keep borrowing costs low by dividing risks into big buckets and reallocating them among hundreds of investors. With nearly half a trillion dollars' worth issued in 2006 alone, and with the risks widely dispersed, investors are willing to put more skin in the game. Financial innovation in the form of CDOs has changed the risk premium associated with the bond market," says McVey.

MARKET FUEL

PUT THE TWO TOGETHER—bigger markets and innovation—and you have the makings of a global financial revolution. Adding more fuel, exchanges are becoming more entrepreneurial—which, as always, brings down costs. There's bustling competition from online exchanges as well. "When oil prices were very high and airlines needed to hedge the prices of fuel with options, they had no idea if investment banks were ripping them off, because there was no transparency in the price," says David Gershon, CEO of Superderivatives Inc., an online derivatives and options exchange. Gershon's outfit is among a handful of startups that allow investors to trade sophisticated instruments online. He argues that exchanges like his make markets more transparent and create more liquidity.

These changes have helped reduce the real cost of capital, best measured by the interest rate on low-risk Treasury bonds. Economists don't expect much of a change over the medium term. The Congressional Budget Office projects 10-year rates will average just 5.0% over the next five years, compared with 4.8% today. Even more important is the decrease in the risk premium on corporate borrowing. Investment-grade bonds, issued by the healthiest companies, might enjoy a quarter-point decline in their spread over the low-risk Treasury rate long term. "Junk bonds, says Wyss, "we could get a bigger permanent impact on keeping spreads lower, maybe 100 basis points"—one full percentage point.

The increased efficiency has been ben-

Why Housing Hasn't Hit the Skids

BY PETER COY

So this is the much-feared "housing bust"? Bust Lite is more like it. Existing-home prices are as high as they were a year ago, while sales have receded only to 2003 levels. The only extreme decline is in construction: Builders are trying to get rid of the houses they've already built before they put up more. The overhang of unsold homes could be back to normal by around midyear.

The credit goes, at least in part, to low interest rates. Fixed-rate 30-year mortgages averaged a modest 6.2% in the last quarter of 2006—well below a decade ago (chart). That, combined with income growth, means houses in most areas remain affordable even though prices rose more than 50% nationally in the past five years. The affordability index of the National Association of Realtors is still over 100, meaning a family making the median income can afford to buy a median-priced house.

The market began gaining momentum in 2001 when the Federal Reserve started lowering rates to end a recession. Corporations cut back on borrowing, but homebuyers exploited the low-cost money. Says Citigroup economist Steven Wieting: "The housing sector acted as a bottom feeder, taking advantage of cheap capital flows."

The surprise is that low rates are still keeping a floor under housing. Thirty-year mortgage rates are no higher than in June, 2004, even though the Fed has since pushed up the federal funds rate by 4.25 percentage points. It's the same



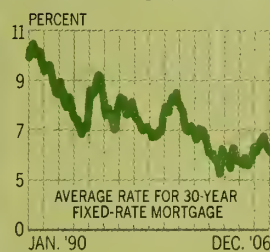
in Britain, where long-term rates have actually fallen since 2004 despite short-term rate hikes by the Bank of England. No surprise: After a brief lull, Britain's housing market is booming again.

Globalization and financial innovation are two key factors in keeping rates low. Investors know more about the loans they're buying, so they will pay more for them. "It's become a much more attractive asset class, hence more dollars are chasing the mortgage market, hence lower rates," says Bryan Whalen, a portfolio manager at Los Angeles-based

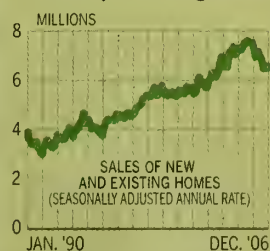
Metropolitan West Asset Management. As recently as three years ago, he says, investors in mortgage-backed securities received two-page summaries of the portfolio. Now they get data on each loan.

Credit default swaps, which let people bet for or against a bond or loan's creditworthiness, have also improved transparency. If investors bet heavily against an issuer's securities, its lending costs are driven up. "This pushes out the marginal lenders," says Whalen. That creates a healthier market—and ultimately, lower rates.

HOUSING HANGS IN Low mortgage rates...



...have kept housing afloat



Data: Freddie Mac, Citigroup

official so far. Companies gain from a lower cost of capital in the form of lower interest payments and higher profits. If rates had not stayed so low, corporate earnings would be about 10% lower than they are today.

Naturally, lower capital costs have made it easier to borrow. Duke Energy Corp., a \$16.3 billion electric and gas utility based in Charlotte, N.C., plans to boost capital spending by \$1 billion a year over the next three years to build new power plants to keep up with the growing demand. Duke may borrow the money instead of drawing down its cash, says David L. Hauser, chief financial officer, since "interest rates have remained surprisingly low." Robert M. La Forgia, chief financial officer of Hilton Hotels Corp., says low rates were critical to his company's ability to purchase its international hotel operations last February, uniting Hilton brands that had been apart for over 40 years. The company put together a \$5.5 billion bank line at just 1.5 percentage points above the rate London bankers charge one another. "It's part of what made this deal possible," he says.

But the downside of the long-term trend is short-term financial market excess. It's here, and it's real. "The economy is robust, [but] we've entered into this new phase where the markets are financing riskier transactions," says Mariarosa Verde, head of the Credit Market Research team at Fitch Ratings Inc. Excess is especially evident in the corporate credit markets, where covenants, which protect investors by requiring companies to maintain healthy financial ratios, are becoming less restrictive. Some companies are jamming investors in other ways. When Pittsburg (Tex.)-based Pilgrim's Pride Corp. raised money to buy another poultry processor in January, it issued bonds that allow it to use projections rather than actual results

The Triumph of the 'Pork-Belly Crapshooters'

BY JOSEPH WEBER

Years from now, this decade might come to be viewed as the golden age of high finance. New markets are sprouting up everywhere, drawing huge amounts of capital and helping hold down rates. And the action is no longer confined to New York. Chicago in particular has emerged as a financial hub in its own right—with plenty of other cities coming on strong.

At the center of the explosion of markets and capital is vigorous competition. Banks, exchanges, and cities are vying for lucrative new trading business by focusing on three selling points: price, speed of execution, and innovation. The result can only benefit borrowers, who end up with a lower cost of capital.

The rise of Chicago's financial exchanges—and their current plans to expand—is emblematic of the creativity and entrepreneurial zeal worldwide that have helped create today's low-rate environment.

In the 1970s, Leo Melamed was casting about for some way to increase the Chicago Mercantile Exchange's competitive edge against its crosstown rival, the Chicago Board of Trade. But the notion of looking beyond cattle, pigs, and other farmland products to currencies and financial instruments seemed crazy. "The world thought it was foolish," recalls the CME's former chairman and current *éminence grise*. "How could a bunch of pork-belly crapshooters be trusted with foreign exchange?"

Undaunted, Melamed went on to develop financial futures, arguably the most important new financial product since the rise of stock markets. Now futures on everything from Treasury securities to European weather allow corporate treasurers, investors, and traders to lay off risks. This allows capital to flow more freely, which is essential to keeping rates low. The growth has been staggering: Chicago's two big exchanges handled more than 2.1 billion contracts last year, or 9 million

to meet certain financial tests for borrowing more money. Pilgrim CFO Richard A. Codgill notes that the projections have to be "reasonable." Hospital chain HCA Ltd.'s latest bonds include some with provisions that let the company use debt instead of cash to make interest payments to bondholders. It works essentially like an IOU that increases HCA's debt down the road. Says Kennedy of PIMCO: "The

bottom line is that when there's too much money in the market, [investors] lower [their] standards." What's more, markets are depending on instruments that are highly leveraged, numbingly complex, and untested by a market downturn.

Then again, derivatives might cushion the blow when the reckoning comes. When hedge fund Amaranth Advisors went under, says Brown of Lord Abbe-

objection

sustained



PARTNERS Duffy and Donohue will face stiff competition

contracts a day, up from 700,000 a day in 1986. And their innovations spurred the global market for over-the-counter derivatives, which has ballooned to around \$300 trillion.

Like lots of revolutionary ideas, the notion behind financial futures is simple. For decades farmers would sell off parts of their crops months in advance to traders in the Chicago markets. The farmers got cash up front and didn't have to fret as much over bad weather or poor harvests. The traders got contracts they could then sell to others, making or losing money as harvest day neared and the crop looked more certain. By applying the same principle to currencies, first in 1972, the CME helped executives of multinational

companies lay off the risk of fluctuating pounds or francs. Since then, the CBOT and CME have expanded to other types of derivatives and are still adding more. Soon traders will be able to wager on the price of commercial real estate and the likelihood that companies such as Tribune Co. will go bankrupt.

But the global competition is forcing the Chicago exchanges to look for bigger scale and more efficiency to offer investors and borrowers better deals. Not only do they do battle with energy-oriented futures bourses in the U.S. but they also face Eurex, a European market that now leads the world in derivatives trading. Soon, China will step up its participation in futures with a new bourse in Shanghai expected to open this year. The appeal of futures is even blurring the lines among exchanges, as the New York Stock Exchange, armed with a new derivatives unit that will come in with its Euronext acquisition, looks to expand.

All that competition is the reason the CME and the CBOT plan to merge by midyear in an \$8 billion deal. The CME hosts stock index and currency futures, while the CBOT is home to Treasury contracts. CME Chairman Terrence A. Duffy and CEO Craig S.

Donohue will hold the same positions at the combined CME Group. Together, the two exchanges will shoot past Eurex, with as many as 600 million more contracts traded yearly.

The exchanges are also hungrily eyeing expansions into the OTC market, a move that could provide investors and borrowers with more choices. Eurex soon plans to start trading a contract based on European credit default swaps, itself a multitrillion-dollar market. "The new Chicago entity is going to be under terrific competition as global alliances appear," says Michael Henry, a senior executive in the capital markets practice at consulting firm Accenture Ltd. For its part, the CME has teamed up with Reuters Group to push into the foreign exchange market and the OTC market for other derivatives known as interest-rate swaps.

Bold ideas in finance underlie all the growth. And thanks to expanding global competition, there's plenty of reason to believe it will continue. "If we weren't innovative throughout the years, we'd still be trading butter and eggs," says CME's Duffy. As long as there's money to be made and the ideas keep coming, the cost of capital will drop even further.

Chicago's innovations are driving growth in other markets

of its losses were covered in the derivatives markets. "It barely caused a ripple," says del Missier. "We haven't done away with dislocations in markets, but markets are much more able to deal with dislocations, and their impact will be less." Over the long term, the big issue is the development of better financial systems in China, India, and other emerging markets. Right now money is pouring into

real estate rather than infrastructure, education, and other essential investments. As financial systems improve in these countries, they will likely make better use of their own money. When that happens, the cost of capital around the world will go up.

But that's a long way off. In the meantime, rates are likely to remain low. "Whatever shocks are ahead," says del Missier,

"the markets are better positioned to deal with them than they've ever been." ■

—With Mara Der Hovanesian in New York, Christopher Palmeri in Los Angeles, and Stanley Reed in London

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MEDIA MOGULS

NOW JEFF ZUCKER MUST PROVE HIMSELF YET AGAIN

The rap on the wunderkind: He lacks the strategic vision to lead NBC Universal in a volatile digital world

BY DIANE BRADY

FOR TWO YEARS, IT WAS THE worst-kept secret in the media and entertainment world. Jeff Zucker, the boy wonder with the P.T. Barnum shtick, was General Electric Co.'s slam-dunk choice to replace Bob Wright as chief executive of NBC Universal Inc. Reading the tea leaves wasn't hard. GE CEO Jeffrey R. Immelt had barely bothered

to interview outsiders for the job. Besides, so many top executives had left NBC Universal in recent months that few of Zucker's internal rivals were left standing.

Still, by Feb. 6, when GE finally got around to announcing what everyone already knew, skeptics had spent months wondering aloud if Zucker, 41, had the strategic vision and background to lead the \$16 billion media company in a YouTube universe. Even Immelt acknowledges that

complacency was partly to blame for NBC's slide from first to fourth place in prime-time ratings during Zucker's three years as head of the TV group. "It's actually hard to go from No. 1 to No. 4. When we were on top, we didn't take enough risks to the next generation going," he says. "[I] stayed too true to what was *Friends*, which was formulaic."

Hence all the head-scratching among industry insiders, who continue to a

AT THE CONTROLS

Zucker seems to focus on the big splash

Is Jeff Zucker the right guy to lead NBC Universal?

No one would deny that Zucker has had an extraordinary run. From the moment he took the reins of the *Today* show as executive producer at age 26, he impressed superiors with his energy, smarts, and willingness to take risks. While insiders credit former news chief Andy Lack with starting *Today's* turnaround, Zucker created buzz with features like outdoor concerts and fought hard to bring in the biggest names of the day. "Zucker made the first 20 minutes of that show must-watch TV," says an industry executive. Former co-host Katie Couric credits

with making the show "smart, hip, innovative, edgy." Zucker liked being in control room, making things happen. The show really played to my interests," says. "I'm interested in everything." By most accounts, Zucker had a rough time when he headed to Hollywood in 2000. He went there largely to reorganize a demoralized team—and won out for getting that done. But his new job as president of NBC Entertainment required him to choose shows for prime-time schedule. While Zucker characterizes his years in Los Angeles as muddled success, his tactics were not universally applauded. Zucker earned a reputation for rubbing the town's delinquents raw, and he raised eyebrows switching shows around, including *Survivor*, which ran in several time slots.

ETCHING FRIENDS

IE DID AT *Today*, Zucker instinctively did after the big splash. He made tactical moves that let NBC prolong its dominance. To maintain the *Friends* advertising juggernaut, he extended each show by 10 minutes. In one stroke, he made it hard for

people to tune in to rival networks. That was great for NBC; not so good for viewers. He also paid *Friends'* stars huge sums to stick around.

What he didn't do was dream up the next generation of programming. When it comes to picking hits, Zucker has had a decidedly mixed record. He championed *Father of the Pride*, an animated series about a family of lions, that made its debut in 2004. It bombed. What attracted him to the show, insiders say, was the pedigree of producer Jeffrey Katzenberg—another echo from his *Today* days, when getting the celebrity *du jour* was his stock in trade. A much-hyped *Friends* spin-off, *Joey*, was a disappointment, too. "People [tried] to criticize me for not finding the next *ER* or *CSI*," says Zucker. "We [hit] a bunch of doubles."

Maybe so, but his choices helped push NBC's prime time into free fall in 2004—sparking rumors that Zucker could be fired. Instead, he was promoted to head of the television group, adding the strong cable assets to his portfolio. Once again, Zucker had demonstrated a striking ability to win maximum applause for coups—bringing *The Apprentice* to NBC, for example—while deflecting heat

for failure. Listen to him talk about NBC's ratings slump. "We had 10 unprecedented years of being on top," says Zucker, "followed by two years when we were not."

But Immelt himself was becoming frustrated with the poor performance at NBCU. After all, it was the only GE business to post shrinking profits last year. Before long, Immelt was coaching his protégé in weekly phone calls. Zucker got GE religion, embracing efforts to boost the bottom line. Mostly that meant taking an ax to production and marketing costs, and laying off 700 people, under a campaign benignly labeled NBCU 2.0. Meanwhile Zucker savvily demonstrated public support for such GE imports as Beth Comstock, who now oversees digital media, and new ad sales chief Michael Pilot, who came from GE's equipment-financing business.

NBC has clawed its way back up in ratings, thanks in large part to the success of the series *Heroes*. But there are other heroes, too. One is NBCU Sports & Olympics Chairman Dick Ebersol, who came up with the idea of bringing back *Sunday Night Football*, giving NBC a rat-

ings boost and a place to promote new shows. Another is current entertainment chief Kevin Reilly. Zucker began giving him public support as ratings began to recover last fall.

But the big winner is Zucker, who sits astride an empire that includes a movie studio, theme parks, cable properties, the iVillage Web site, and NBC. Much of the business is doing fine—from the hugely profitable USA Network to the still dominant *Today* show. But to keep NBCU growing, Zucker will have to move beyond the short-term urgency of TV to deal with issues like piracy, globalization, new distribution models, and a shrinking audience for network TV. Wright, 63, was brilliant at looking around corners—positioning NBC for the onslaught of cable and launching CNBC before the market boom. "Bob had

a great way to conceptualize the unknown," says Immelt. Wright is as comfortable talking about regulatory trends in Washington and Beijing as the latest technologies in Silicon Valley.

While Zucker acknowledges that "the biggest challenge for us to figure out is what we will look like in five years," some wonder if his DNA remains rooted in thinking about today.

"He cares more about getting a rise out of [CBS chief] Les Moonves than figuring out what YouTube does to his business," says one observer. Under his leadership, Zucker predicts NBCU will emerge more "optimistic, competitive, very sunny-side-of-the-street, very encouraging." Less certain is how he'll fare as a strategist.

Immelt, of course, expresses confidence Zucker will make NBCU a winner again. He says Zucker has the edge and creativity to make the best of a bad situation. "I like how tough he is," says Immelt. "I watched Jeff go to the bottom of the ocean, around the middle of last year. He never got negative." Immelt believes Zucker is a fast learner, noting that every CEO has to grow into the job. But Immelt also acknowledges the media and entertainment industry faces the toughest challenges of any of GE's businesses.

The question for Zucker is how long he has to prove his mettle. Although GE says it is in for the long haul, insiders buzz that Wright and others have looked hard at selling NBCU. As Zucker knows all too well, it will take more than bravado and political savvy to impress his boss. ■

"People [tried] to criticize me for not finding the next *ER* or *CSI*," says Zucker. "We [hit] a bunch of doubles"



CORPORATE GOVERNANCE

PROXY- SEASON GRIDLOCK AT THE SEC

By not ruling on investor power in board elections, it's setting the stage for a fracas

BY LORRAINE WOELLERT

IN THE 18 MONTHS CHRISTOPHER Cox has led the Securities & Exchange Commission, he's made great strides toward unifying a fractured agency, racking up a string of unanimous votes on even polarizing issues such as executive pay disclosure. But now Cox's drive for consensus is slowing the agency's response to one of the most urgent issues in business: the growing power of shareholders in corporate elections.

In September a federal appeals court attacked an SEC policy that for years had effectively blocked investors from getting their candidates for the board of directors on the ballot. Cox promised swift action to create "one clear rule" to govern board elections. But the commission failed

to take up the matter at its October meeting and punted again in December even as executives pleaded for guidance on the eve of proxy season. "The SEC has allowed this to fester, and it now is simply getting out of control," says Peter J. Wallison of the American Enterprise Institute, a free-market think tank in Washington. "It has left companies just hanging out there, completely with-

Proxy Problems

Activist shareholders at three companies want to change corporate bylaws to make it easier for investors to propose their own slate of candidates for the board of directors. Here's how the companies are responding:

HEWLETT-PACKARD

HP included a proposal in its proxy after the SEC refused to weigh in on the company's behalf

RELIANT ENERGY

After witnessing HP's loss at the SEC, Reliant filed suit to block a resolution from Seneca Capital

UNITEDHEALTH GROUP

The company is using Minnesota state law to try to exclude a proposal from CalPERS

COX Trying to build consensus among commissioners

out any defenses. Activist shareholders are glee to have the up hand. "This is t accountability me

anism shareholders have been searchi for for at least 30 years," says Richard Ferlauto, director of pension policy at t American Federation of State, Cour & Municipal Employees. AFSCME h challenged the long-standing SEC rule a 2005 lawsuit against insurer Americ International Group Inc., ultimately p vailing at the U.S. Court of Appeals t the Second Circuit.

NO RETURN TO THE OLD DAYS

ARMED WITH THE Second Circ opinion, investors are pushing pro proposals at Hewlett-Packard, Relia Energy, and UnitedHealth Group. three sought the SEC's blessing to or the proposals from their proxies. But a Jan. 22 letter to HP, the SEC declined take a side. AFSCME sued to ensure t would include the proposal, which t company did.

HP's experience prompted Reliant file its own lawsuit. On Feb. 5 the comp ny asked the U.S. District Court in Hot ton to block an election proposal fr Seneca Capital Investment Partnersh UnitedHealth, based in Minneton Minn., hopes to use state law to exclu similar resolution from its proxy.

Corporate lawyers blame the SEC the chaos. "We were surprised by the S response to Hewlett-Packard," says Re ant attorney Michael P. Rogan, a part at Skadden, Arps, Slate, Meagher & Flo "We didn't expect to get to this point." N did business lobbyists, who are hamm ing the SEC to issue a new rule that v give business the means to fight back.

Business shouldn't count on speedy fix or a return to the old days. Cox works to build support among co

missioners eveny sp between Democrats a Republicans, he mal clear his intent to expa shareholder rights: " have any number of s ical committees telling that in order to be m competitive, the U.S. has sharpen its edge," the S chief says. That means t only lightening the r latory load "but also m ing sure that sharehol rights are thoroughly spected." ■

Data: BusinessWeek

NANCE

TELECOM: UP FROM THE IPO ASHES?

Maybe it's not 1999, but an offering from MetroPCS could fetch \$1.2 billion

AARON PRESSMAN

IT DOESN'T EXACTLY HAVE THE makings of a hot IPO. Back in the 1990s, Dallas-based MetroPCS Wireless Inc. filed for bankruptcy after getting caught up in the industrywide land grab for network licenses. Then had to cancel plans to go public in 2004 when company auditors found accounting problems. Still, if MetroPCS raises \$1.2 billion from the equity markets in the next couple of months, as it hopes, the deal would be the biggest U.S. telecom initial public offering since 2000.

It's little wonder why telecom stocks have dried up. In the mad rush to expand in the late 1990s, most players overpaid for licenses and constructed networks that were too big for the existing pool of customers. When the bubble burst in 2000, the companies crashed, sending many into Chapter 11. After that, telecom became a dirty word on Wall Street. In 1999 and 2000, 62 telecoms raised roughly \$22 billion, including the \$10.6 billion IPO of SBC Wireless Group in April, 2000. But for the next five years there were only 21 IPOs in the sector, totaling \$5.6 billion, according to Thomson Financial.

Yet analysts think investors will embrace MetroPCS. For one thing, telecom stocks, led by mobile players, gained 35% in 2006, compared with 15% for the Standard & Poor's 500-stock index. And among fast-growing wireless companies, MetroPCS stacks up nicely. The company, which serves seven metropolitan regions including Atlanta and San Francisco, doubled its customer base in a year, to 2.6 million as of September, 2006. Revenues jumped 46%, to \$1.1 billion, for the first nine months of 2006. Its accounting problems have also been resolved: The company restated its revenues and income

modestly for 2003 and 2004, while overhauling its accounting procedures and replacing some of its top finance people.

In this crowded market, MetroPCS has also managed to distinguish itself from the big boys like Verizon Wireless Inc. and Cingular Wireless. Rather than offering calling plans with bundled minutes, hefty overage fees, and annual contracts, MetroPCS charges customers a flat, prepaid rate of \$30 to \$45 a month for unlimited calling. Its phones are cheaper, too. "It may seem like every man, woman, and child has a cell phone, but the next leg of growth will be with the lower-income, younger people, and the undocumented," says Ric Prentiss, an analyst with Raymond James & Associates. "You need a unique way to do that [like the MetroPCS plans]." It also keeps marketing costs down by relying largely on word of mouth and local advertising. Last year, MetroPCS spent just \$116 to add a new customer, less than half what big carriers pay.

FULLER SPECTRUM

IT'S A SIMILAR MODEL to that of San Diego-based Leap Wireless International Inc. Although the two have been locked in legal battles over a patent since the summer, there's room for both to thrive, says Christopher Watts, an analyst with Atlantic Equities. If Leap's 79% stock gain over the past year is any indication, it's a model that investors should like. "These are growth stocks with straightforward expansion plans," Watts says.

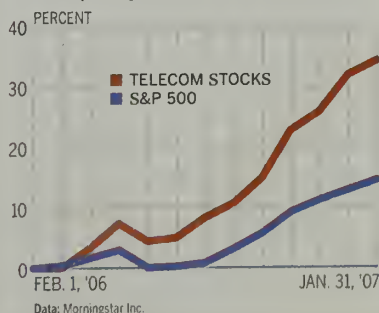
That expansion is the reason MetroPCS founder and Chief Executive Officer Roger D. Linquist is reaching out to the equity markets. MetroPCS was one of the most aggressive bidders at the Federal Communication Commission's spectrum auction back in November. The company picked up licenses for eight areas, including New York, Las Vegas, and San Diego—representing 117 million potential new customers. MetroPCS raised \$1 billion in the bond market to help pay the \$1.4 billion tab for new licenses. It plans to use the proceeds from the stock offering to build out services in those new regions, according to IPO filings. MetroPCS executives declined to comment.

Last year's big telecom IPO, Vonage Holdings Corp., was a dud, with the money-losing Net telephony outfit down 70% since its May debut. But with growing revenues and profits, MetroPCS should fare much better. ■



TAKING OFF

The telecom sector has soared in the past year



Kodak's Moment of Truth

How the ailing film giant,
led by a refugee from HP,
embarked on a risky strategy to
reinvent the inkjet printer

BY STEVE HAMM



ANTONIO M. PEREZ left the consumer inkjet printer business seven years ago after he lost out to Carly Fiorina for the top slot at Hewlett-Packard. But it has never been far from his mind. That's why, a few weeks after he joined a struggling Eastman Kodak Co. as president on Apr. 2, 2003, he was peering into a microscope in a lab on Kodak's sprawling Rochester (N.Y.) campus. Perez was amazed at what he saw: droplets of a new ink Kodak scientists had produced promised to yield photo prints with vivid colors lasting a lifetime. "It was the Holy Grail of inkjet printing, and they had it here," he recalls.

Ever since then, Perez and Kodak have been working on a top-secret plan, code-named Goya, to make a big entrance into the consumer inkjet printer business. For the past year a Kodak development team has been putting the finishing touches on printer technologies in a nondescript building across the street from HP's ink-

jet printer lab in suburban San Diego. On Feb. 6 it became clear what they were up to when Perez, now Kodak's chief executive, rented out the *Saturday Night Live* studio in New York to unveil a line of multipurpose machines that not only handle photographs and documents but also make copies and send faxes.

The Kodak printers are designed, first and foremost, to print high-quality photos: The ink is formulated so prints will stay vibrant for 100 years rather than 15. Most impressive of all, replacement ink cartridges will cost half of what consumers are used to paying. The new printers will arrive in stores in March, priced at \$149 to \$299. Black ink cartridges will cost \$9.99, color \$14.99. If consumers buy Kodak's economical Photo Value Pack, which combines paper and ink, the cost per print is about 10¢, vs. 24¢ for HP's comparable package. "It's really a revolution

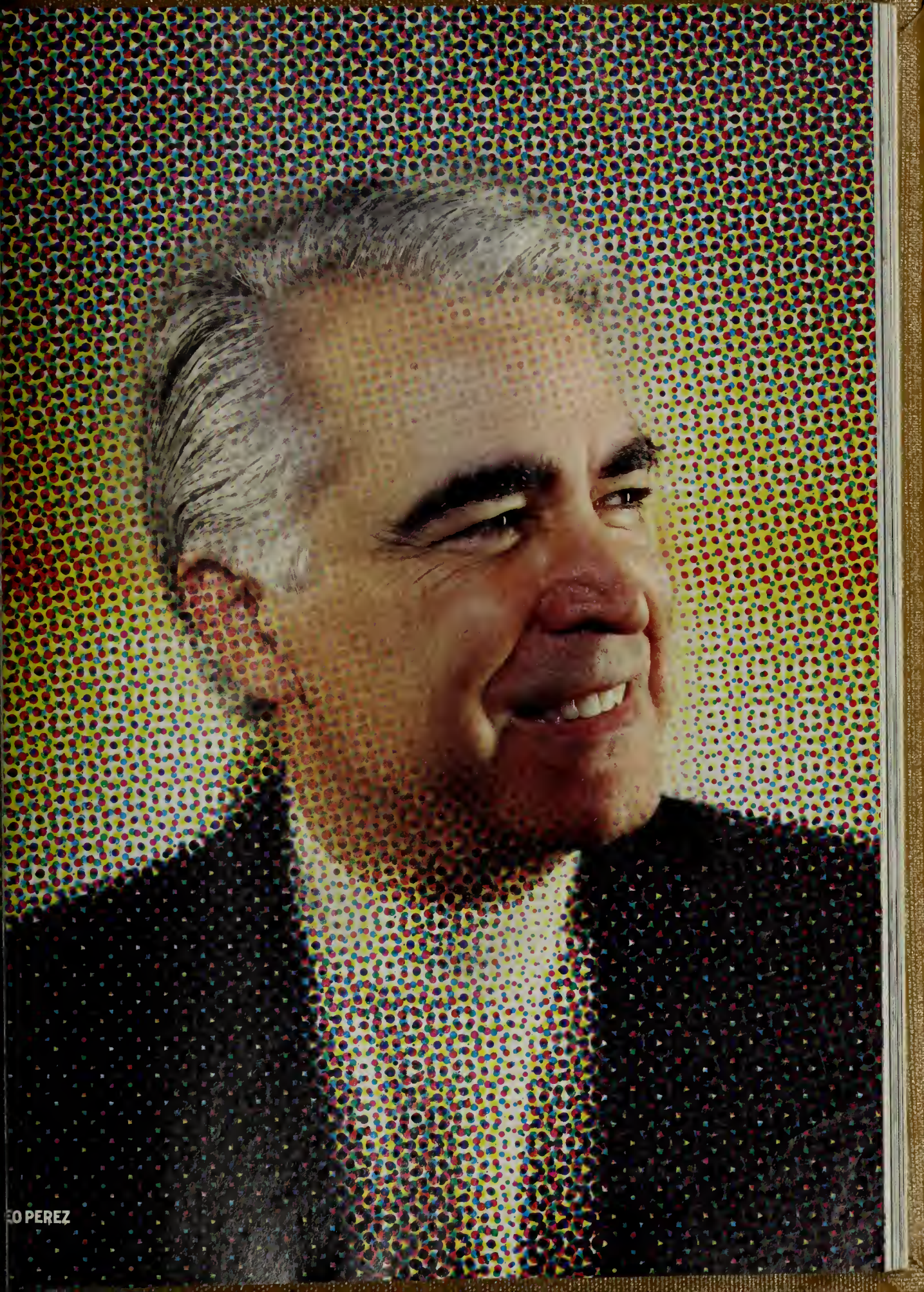
of thought in how to bring the price of printing down and encourage people to print more," says David Morrish, senior vice-president of merchandising for Best Buy Co., which has an exclusive on the product for three months.

UPENDING THE MODEL

IF KODAK PULLS THIS off—and that's a big if, considering the forces it's up against—it could pose a huge challenge to the \$50 billion printer industry. Those companies now rely on a razor-and-blade strategy, often discounting machines and making most of their profit on replacement cartridges. "We're very proud that we're coming to market 20 years late," Perez says with a grin. "We think it will give us an opportunity to disrupt the industry's business model and address consumers' key dissatisfaction: the high cost of ink."

In particular, Kodak

**The cost per
Kodak print
could be as
low as 10¢,
vs. 24¢ with
HP's system**



EO PEREZ

"QUEEN OF THE GEEKS"

Inkjet R&D head Tousi kept sending the engineering staff back to the drawing board until they got it right



strategy is an assault on the profit engine of industry leader HP. Printing supplied 60% of HP's \$6.56 billion in operating earnings last year. Yet Perez claims he has no malice toward his former employer. "I spent my life there. I respect them," he says. "I'm doing this for Kodak."

Perez predicts the inkjet printers will become a multibillion-dollar product line. He'd better be right. Kodak has struggled for years to find a replacement for its rapidly declining photo-film business. In the fourth quarter the company posted its first profit in two years, a reflection of cost cuts, not rising sales. If he doesn't show growth soon, investors could bail out.

SCANNING OPTION

HIS LAST, BEST HOPE is to create a multifaceted printer-and-imaging business, a smaller version of the one that generated \$26.8 billion in revenues for HP last year. Consumer printers are just the latest piece of that strategy: Perez already has a fast-growing but low-margin lineup of digital cameras, docking-station printers for cameras, an online site for managing

and printing pictures, and a commercial inkjet business. Perez is cooking up such services as one that lets people run shoeboxes of old prints through a store scanner, quickly organizing and enhancing the images. And all the while he's been accumulating cash by shucking such major businesses as his medical imaging unit, whose sale to Onex Healthcare Holdings Inc. for \$2.5 billion was announced in January.

What's been missing so far is anything that replaces the once-huge profits Kodak made on film. Perez insists that even while charging lower ink prices,

he can extract double-digit operating margins from consumer inkjet printing within three years. He says Kodak cuts costs by putting its print heads in the machine rather than in the replacement cartridges, which saves on materials and manufacturing. Plus, Kodak is using a lot of off-the-shelf parts.

But Kodak is up against a juggernaut. HP enjoys a huge advantage in shelf space at stores ranging from office supply chains to supermarkets and has done a masterful job of sharing some of its printer profits with retailers. All told, HP spends about \$1 billion a year on printing research and development alone, which helps it continually find ways to improve printing speed and quality. Industry analysts expect HP to sit back and wait to see if Kodak's new machines get traction. If they do, HP could respond with selective discounting. Already, there are signs that HP is ready to defend its turf with tough tactics (page 48). "[Perez] is going into gunfight with a knife," says Nils Maddox, marketing director for HP inkjets.

The Feb. 6 unveiling of Kodak's printers signals the end of a remarkable 3½-year forced march to get a potentially revolutionary product out the door. Perez built his team by matching a slew of former HP colleagues with Kodak chemists and nanotechnology experts. Perhaps never before has a challenge to a major company been launched by a rival that knew it so well.

Seeds of the project were planted



What Makes **Printer Ink** So Pricey

Kodak could disrupt an industry that profits by selling replacement ink cartridges at \$30 a pop. Kodak will halve that. Here's how printer makers have kept ink prices so high:

RAZORS AND BLADES

All of the major inkjet printer makers have chosen the same strategy, selling printers for low prices and more than making up the difference on replacement cartridges.

TO EACH HIS OWN

Each inkjet printer company tunes its printers, paper, and ink cartridges to work well together. If consumers mix and match, they risk getting a crummy print.

COPYCATS

Independent outfits make replacement cartridges for HP, Canon, or Epson printers but lack access to secret ink and printer technologies, so quality varies. And they seldom offer much of a discount.

STRATEGIES

A Totally Different Picture

In the late 1990s, when HP briefly considered acquiring Kodak, during a 15-day due-diligence process, Perez looked over Kodak's patent portfolio. Although HP's board nixed the merger, Perez' prowling later resulted in a joint venture, established in 2000, to produce high-quality inkjet photo printers for retail outlets.

The project, Phogenix Imaging, was ultimately a bust, a victim of conflicts between the owners. On May 14, 2003, with the first machines ready for shipment on the loading dock and only a month after Perez had joined Kodak, the two sides announced they would part company.

But Phogenix wasn't all for naught. Perez had hired two former top HP printer executives, Bill Lloyd and Philip S. Faraci, to help him evaluate the consumer inkjet business at Kodak. In 1979, Lloyd had led the HP team that came up with the key advance in inkjet printing that created the industry. As soon as the Phogenix news came down, Lloyd and Faraci were on the phone with about 40 key employees, many of them former HPers. They couldn't talk about Perez' ambitions yet, but "we called them up and asked them not to take other jobs," recalls Lloyd, who is now Kodak's chief technology officer.

The crucial go/no-go meeting came on June 25, 2003, in Perez' conference room on the sixth floor of Kodak headquarters. Lloyd and Faraci laid out the arguments, pro and con. The risks were enormous. Kodak would be entering a mature business already dominated by a handful of leaders. And with Kodak's turnaround in question, Perez couldn't afford an expensive failure. But the rewards were huge, too. Perez decided to sleep on it. He stayed fitfully all night at his home in the posh Pittsford neighborhood of Rochester. By morning he had his decision. "The industry had been doing things the same way for 20 years, and it was time for a change," he says. He called up Bill Lloyd and said: "Go ahead. Let's launch a full program."

In its heyday, Eastman Kodak Co. was an icon of innovation. Now that its core film business is fading like an old photo, Kodak is fighting to climb back as a leader in digital photography. Its new line of inkjet printers is a critical piece of that strategy. "This is a do-or-die product for Antonio Perez," says Charles LeCompte, president of Lyra Research Inc., an image research firm in Newtownville, Mass. "If they want to make money in consumer imaging, they had to get into printing."

Perez is attempting the most difficult challenge of a CEO: revamping his company's business model. His answer has been to position Kodak as the Apple Inc. of pictures. He is building a portfolio of digital cameras, Web services, and retail photo kiosks that will help consumers manage their proliferating collection of digital photos. And he is moving aggressively to license Kodak's intellectual property and beef up its presence in the high-end commercial printing market. In the most recent quarter, \$123 million, or 82% of the operating profits of Kodak's digital imaging group, came from licensing deals.

But Kodak's transformation has not yet translated into financial success. The digital world brings tougher rivals, lower profits, and increased investment needs. Last year sales from Kodak's film and film printing business fell 22%, to \$4.2 billion, while its digital imaging group saw sales drop 9%, to \$2.9 billion, largely because Kodak stopped selling low-end digital cameras. Overall, the company lost \$600 million in 2006 and \$1.4 billion the previous year.

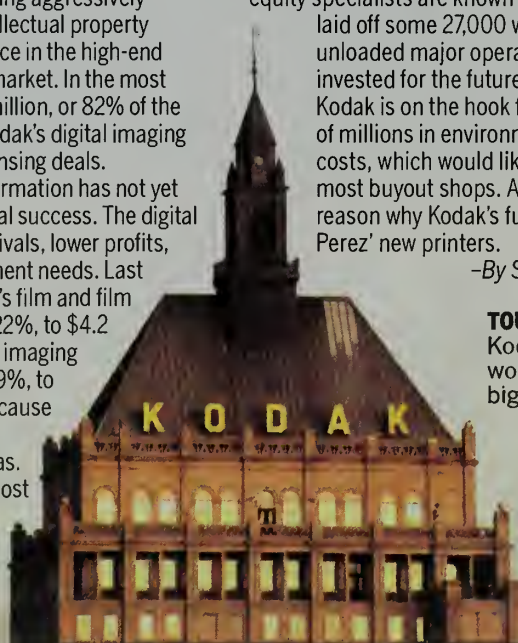
That's what makes the consumer printing effort so important. If inkjet printers and cartridges prove popular, they could provide the kind of ongoing, high-margin revenue that film once did. "The profit potential is compelling," says Matthew Troy, an analyst with Citigroup Global Markets. And if the new printers don't catch on? Kodak may well be relegated to bit-player status in the consumer market. Says LeCompte: "They would end up as the rump of a company in commercial imaging."

That definitely would be a blow to investors, who have bid up Kodak's shares from a five-year low of 19.09 last August to about 26 today. Kodak's strong brand and \$1.2 billion in cash flow from operations last year might suggest it's a candidate for a buyout. But Perez already is making many of the tough choices that private-equity specialists are known for: He has laid off some 27,000 workers, unloaded major operations, and invested for the future. What's more, Kodak is on the hook for hundreds of millions in environmental cleanup costs, which would likely scare off most buyout shops. All the more reason why Kodak's future rides on Perez' new printers.

—By Spencer E. Ante

TOUGH CHOICES

Kodak has laid off workers and sold big operations



A few days later a dozen former Phogenix employees were invited to lunch at the suburban San Diego home of David Clark, who had been the Phogenix R&D chief. They sat by Clark's backyard pool with a view of the rugged Poway Hills in the distance, munched on chicken salad, and listened raptly while Clark laid out Perez' audacious plan. "At first we thought it was a far stretch. We know how capable HP is and how much

technology it has and how much money they spend," recalls Susan H. Tousi, a 10-year HP veteran who now runs R&D for Kodak's inkjet business. Still, within a few days, all but one of those who had sat by Clark's pool decided to sign on. Tousi did so because she liked the startup mentality and wanted to keep working with people who had become close friends.

Perez wanted to get to market quickly, with a target of three years, so the InkJet

1987

1993

1600

1200

800

400



See below for an explanation of this chart. Represents performance period 12/31/86 through 12/31/05.

EQUITY RESEARCH

RATINGS

Since 1987, Standard & Poor's 5-STARs stock recommendations have outperformed the S&P 500 in 15 of 19 years and tied once, and have outperformed the Dow Jones Industrial Average and DAO Composite Index in 14 and 13 of those 19 years, respectively. The above chart represents the hypothetical growth attributable to price appreciation of a \$100 investment in the 5-STARs recommendations for the period shown. Since 1987, S&P has ranked a universe of common stocks based on a given stock's potential for future performance. Under our proprietary STARS (STock Appraisal Ranking System), S&P's equity analysts rank stocks according to their individual forecast of a stock's future total return potential versus the expected total return of the S&P 500 index, based on a 12-month time horizon. STARS are ranked 1 to 5, with 5-STARs stocks expected to outperform the S&P 500 index by the widest margin. ***** 5-STARs (Strong Buy); Total return is expected to outperform the total return of the S&P 500 index by a wide margin over the coming 12 months, with shares rising in price on an absolute basis. "S&P," "S&P 500," "STARS," and "Standard & Poor's" are trademarks of The McGraw-Hill Companies, Inc. The 5-STARs model performance graph is only an illustration of S&P's research. The 5-STARs portfolio is not an actual portfolio and 5-STARs performance does not represent the results of actual trading. Thus, the performance shown does not reflect the impact that material economic and market factors might have had on decision-making. While 5-STARs stocks performed better than the above indices for the period shown, the performance during any shorter or longer period may not have, and there is no assurance that they will perform better than the indices in the future. STARS methodology does not take into account any particular investment objective. Investments based on the 5-STARs methodology may lose money. There is no guarantee that the performance of 5-STARs recommendations in the future will equal past performance. STARS performance does not take into account reinvestment of dividends, capital gains, taxes, or brokers' commissions and fees. The imposition of these fees and charges would cause actual performance to be lower than the model performance shown. The stocks ranked 5-STARs will change over time, and

1999

2005



S&P 5-STAR
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The stocks that received this ranking during the time period shown may not have maintained a 5-STAR ranking during the entire period. 5-STARs lower than 5-STARs have outperformed the 5-STAR category for certain periods of time and may do so again. The S&P 500 index is designed to measure the performance of 500 leading large-cap U.S. companies. The Dow Jones Industrial Average comprises 30 actively traded blue-chip U.S. stocks, including industrials. The NASDAQ Composite Index, containing over 3,000 securities, measures all NASDAQ stocks listed on The NASDAQ Stock Market. The indices are unmanaged, include a different number of holdings, have different risk characteristics than the 5-STARs stocks, and do not reflect fund fees or take into consideration the reinvestment of dividends. For performance calculation purposes, the 5-STARs stocks as of December 31, 2004, are equally weighted. Changes in the composition of the 5-STARs stocks thereafter are made at the average value of the 5-STARs stocks at the period-end, with no rebalancing. Methodologies for the other indices shown may differ. Some of the 5-STARs stocks may have been included in one or more of the indices for some (but not necessarily all) of the period covered by the chart, and some of such stocks may not have been included at all. It is not possible to invest in an index. Past performance of any index is no guarantee of future performance. A complete list of 5-STARs recommendations made for the year is available from S&P upon request. The equity research reports and recommendations are performed separately from any other analysis of S&P. S&P's Equity Research has no access to non-public information received by other units of S&P. S&P does not trade for its own account.

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Once the initial ink recipe was concocted, there was a lot of resistance to changing it

Products Group leaders made choices designed to speed up the development process. They worked with technology partners, such as chip-design specialist SigmaTel Inc., rather than trying to design everything from scratch. And once they established their market goals, in late 2003, they never swerved from them. The result: a process that took years less than it might have and required just a \$300 million investment.

One of the key decisions was choosing pigment as the basis for Kodak's ink rather than the usual dye. Pigment-based inks hold their colors longer, but typically the colors aren't as vivid. So Kodak engineers had to come up with innovations in ink chemistry, nozzle technology, and paper to produce vivid colors that also last. Software in the printer evaluates each image and determines what's in it (faces, trees, sky), optimizing the process based on that analysis.

FORMULA CHANGE

INK IS BOILED AND sprayed through 3,840 nozzles at a rate of 24,000 drops per second. The tiny pigment particles are designed to sit on the surface of porous paper while the liquid they're suspended in is absorbed. Drying takes just 15 milliseconds, so there are no worries about smearing the prints, which take 28 seconds to produce.

With any new technology, there are invariably glitches. The team faced a near-disaster a year ago when they discovered that the pigment particles in their inks were settling at the bottom of the storage containers, like sediment in a wine bottle. Unless the situation was remedied, image quality would suffer. The problem came fairly late in the development process; the team had already "frozen" the ink formula so they could design other components of the printer to go with it.

The temptation was to try to fix things

without changing the ink recipe. The scientists considered putting a small mechanical mixer in the storage tank. But in the end they decided it was too risky to do anything but reformulate the ink. That led to a day-and-night work marathon. A month later the team had its answer: milling the pigment particles much smaller, so they would stay suspended in liquid. The formula was set, and Tousi came up with a new motto: "Don't dink with the ink."

Throughout the whole process Tou-

si was the stickler for quality. Dubbed "Queen of the Geeks" by her employees, Tousi carries a loupe for magnifying photographs practically everywhere she goes. She even takes prints into the parking lot to study them under harsh sunlight. Time and again, Tousi sent engineers back to the drawing board because the results weren't up to her standards.

Last June it was Tousi who had to tell Perez that they weren't going to be able to begin marketing the printers for last year's holiday shopping season. She thought more tests were necessary to assure the highest print quality. In an effort to boost the team's morale, Perez flew to San Diego to meet with the entire engineering staff. He stood on a table so he could see over their cubicle partitions. He recalls telling them: "Slipping by the quarter doesn't matter that much, but you have to promise me that these printers will work perfectly. We have only one chance to do this right. If our first introduction fails, we fail."

Analysts who have seen Kodak's printers have come away impressed. "The print quality is really good. They're at least as good as everybody else," says

TURF WARS

Rivals Say HP Is Using Hardball Tactics

Cheaper store-brand inkjet printer cartridges have come on strong recently and now make up about a quarter of the market for replacement cartridges in the U.S. That poses a serious threat to Hewlett-Packard Co., the worldwide leader in consumer printers. Now, according to printer industry and retailing executives, HP is fighting back.

Those executives say the company has approached chain stores that sell store-brand cartridges compatible with its printers and offered them incentives if they end the practice. Since those replacement cartridges typically sell for 10% to 15% less than HP's, consumers could be the big losers if a lot of retailers take the printer giant up on its offer, they say. "HP has a huge share and market power. By limiting the alternatives a consumer has, it's a

tough strategy," says one executive in the ink cartridge remanufacturing business. (The independent and store brands sell recycled cartridges that they refill.) None of *BusinessWeek's* sources would allow their names to be used because they don't want to damage their relationships with the industry leader.

Asked to respond to the complaints, an executive for HP says it provides incentives to retailers so they will aggressively market its products. But the executive, Pradeep Jotwani, head of supplies for the HP Imaging & Printing Group, wouldn't provide details of those marketing programs. "We don't try to stop the availability of non-HP supplies," Jotwani says. He adds that the Palo Alto (Calif.) company has the customers' interests in mind, and purchasers will get the best results if they use all HP-original technology and sup-



CAMERA Kodak CEO Perez (center) at the printer launch on the *Saturday Night Live* studio

ry Jamieson, director of industry-tracker Lyra Research Inc. But Perez and Kodak are challenging a giant competitor that has a 33% worldwide market share and a sterling reputation among PC and digital-cam-

era users. HP not only gets prime merchandising spots for its printers and ink in stores, but also gets to display its printers in the computer sections, because it bundles printers with its PCs. "HP has a lot of customer loyalty. They build a great product. The printers don't break," says analyst Alyson Frasco of market researcher Interactive Data Corp.

It's up to Perez and Kodak to show

they have a truly game-changing product. Perez seems immune to negative thoughts. He tells a story that shows just how confident he is of success. "J. Paul Getty said you have to do just three things to be successful: get up early, work hard, and strike oil," says Perez. "I didn't strike oil in my career, but I did strike ink." ■

—With Louise Lee in San Mateo and Spencer E. Ante in New York

we want to provide the best customer experience," he says. Staples Inc., the country's largest purveyor of replacement ink, confirmed to *BusinessWeek* it plans on phasing out sales of store-brand inks for HP printers, but won't say whether the electronics giant led it to make the move.

Staples says HP has invested heavily in optimizing its printers, ink, and paper, so the two work well together. "We'll focus on HP-original technology," says Scott Rankin, vice-president for technology merchandising at Staples. "Selling that system is going to enable us to offer our customers the best solution."

Yet Staples will continue to sell store-brand replacements for cartridges from Epson, Canon, and Lexmark International. Rankin says customers still have opportunities to save by buying HP-compatible ink purchases by buying multi-cartridge packages and getting \$3 off for recycling cartridges. Lotwani says he's experimenting with programs that would make for

more efficient cartridge recycling and would also boost the volume of returns. HP takes the cartridges and separates the materials for recycling, rather than refilling them like remanufacturers do. He denied the company is trying to deprive remanufacturers of the cartridges they need to do business.

Industry analysts are watching the action closely. "The speculation is that [Staples] reached a deal with HP and got increased margin and soft money for marketing," says Charles Brewer, managing editor of *The Hard Copy Supplies Journal*, a trade publication that first wrote about Staples' move. "That line is selling very well for Staples. They wouldn't drop it without compensation."

Staples' move has already had reverberations. InkCycle Inc., a Lexena (Kan.) company known to supply ink cartridges that Staples sells under its store brand, has reduced its workforce from nearly 800 last summer to 400 today. InkCycle officials would not comment on HP or their relationship with Staples.

Other retailers, including Best Buy Co. and Office Depot Inc., say they will continue to sell store-brand HP-compatible ink. "We carry what the customers ask for," says Scott Koerner, senior vice-president for merchandising at Office Depot. "As long as the customers continue to ask for it, we intend to continue to carry it. This is about providing customer choice." Asked if the industry behemoth approached Office Depot and asked it to stop carrying store-brand ink, Koerner said: "I can't comment on any conversations with HP one way or the other."

Executives in the ink cartridge remanufacturing industry say they are discussing whether to complain to regulators about the moves, which the executives say may harm consumers. Do these alleged tactics raise antitrust questions? "Antitrust law would only be violated if HP does something that significantly eliminates alternatives from the market and gives it enhanced market power as a result," according to Steven C. Salop, professor of economics and law at Georgetown University Law Center. "Right now, there are alternatives being sold at other office superstores, and other printer brands are being sold at Staples."

—By Steve Hamm

THE STAT

10%

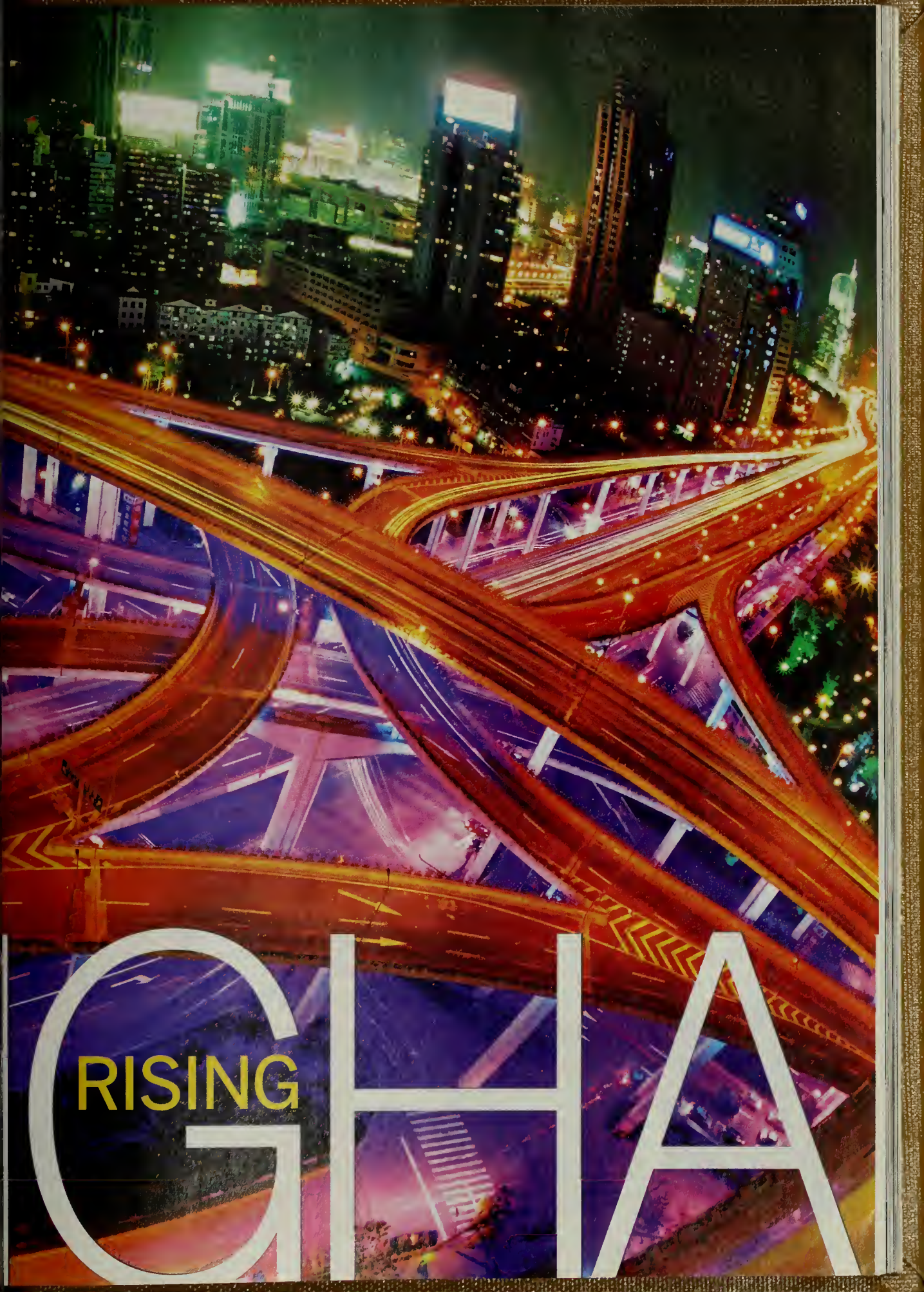
The price differential on store-brand printer cartridges vs. HP-brand cartridges.

Data: *BusinessWeek*

CHINA
STRUGGLES
TO BUILD A
LIVABLE CITY INSIDE
A WORLD-CLASS
BUSINESS CAPITAL

BY FREDERIK
BALFOUR

SHANGHAI



GHANA

RISE

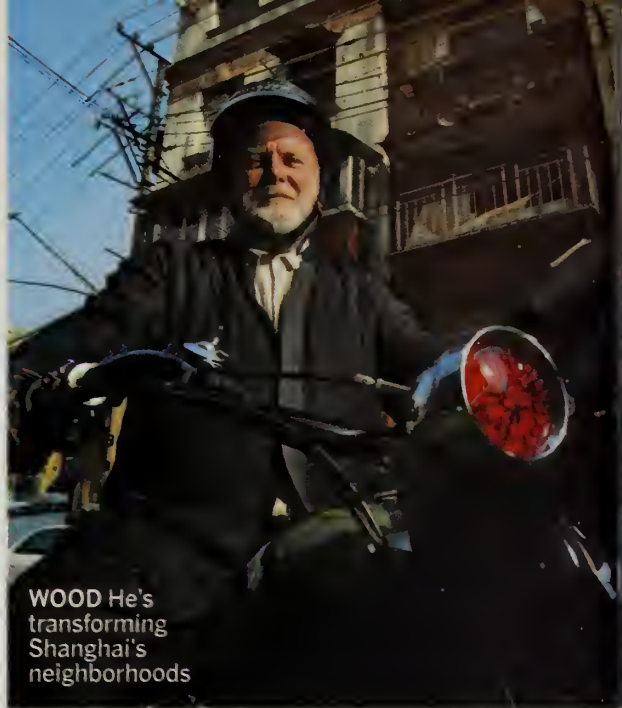
BENJAMIN WOOD SWINGS his bulky frame over the saddle, straps on his helmet, and settles onto a vintage motorcycle with sidecar. The American architect kicks the engine into life with a single thrust and pulls into the rush-hour traffic coursing through Shanghai's trendy Xintiandi district. He soon steers down a narrow street and enters another world. While Xintiandi is all luxury shops and outdoor cafés, in surrounding neighborhoods the sidewalks are full of people playing mah-jongg in their pajamas, washing dishes at outdoor taps, or popping dumplings into bubbling oil. Life goes on much as it has for the past half-century.

As the bike gathers speed, Wood's white silk jacket flaps in the wind. Passing between some of the fast-disappearing courtyard houses of Shanghai, he waves at locals making dinner. "They know me pretty well in this neighborhood, because I like to ride through here a lot," he says, raising his voice to be heard over the growling motor. "What they don't know," he adds with a hint of regret, "is that I'm also the guy who is going to make this way of life disappear."

Although few might recognize Wood, virtually anyone who has spent more than a day or two in Shanghai will know Xintiandi. The rebuilt neighborhood is Wood's first and best-known work in China, a collage of cobblestone streets, narrow alleyways, and graceful tiled roofs. Xintiandi, which translates as "New Heaven and Earth," has become one of Shanghai's top tourist destinations. Foreigners love it because it evokes the colonial era and is one of the few neighborhoods to escape the wrecker's ball, while locals are drawn to the bistros, bars, and boutiques that lend it a Western cachet.

Wood's work at Xintiandi has become a symbol of the changing aspirations China has for Shanghai. In 1992, Deng Xiaoping declared that Shanghai would be "the head of the dragon" pulling the country into the future, and the Chinese have poured tens of billions of dollars into rebuilding the city after a half-century of neglect. The pace has slackened after a scandal over municipal pension money spent on questionable real estate deals, but the city is still booming.

Problem is, Shanghai has long preferred megaprojects that



WOOD He's transforming Shanghai's neighborhoods

blindly ape the kind of high-rise developments that scream "modernity" but have little to do with traditional Chinese culture. Until Ben Wood, that is. Xintiandi represents Wood's signature style: Instead of calling in the bulldozers, he imagines a rundown neighborhood as something refreshed. He rebuilds old buildings, saves the facades of others while gutting their interiors, and designs new structures that blend in.

That graceful melding of old and new fits Shanghai's ambitions as it steams toward its third decade of hypergrowth. Like Renaissance Florence, London in the 1800s, or New York in the 20th century, Shanghai aims to muscle its way into a spot in the global economic order—a role it played back in the 1920s. Today, Shanghai is the mainland's most populous city with 18 million residents. It's home to the Asia headquarters of more than 150 global corporations, including General Motors, IBM, and Alcatel-Lucent. And multinationals are boosting their commitment. GM today employs some 1,800 white-collar workers in the city, 60% more than in 2004, while Citibank now has 2,000 employees there, up from 80 in 1999. "Shanghai has very visible ambitions to be a major financial center in the region and perhaps beyond," says Richard Stanbury, CEO of Citigroup China.



City of Dreams

Key Projects in Shanghai



«XINTIANDI

American architect Benjamin Wood's first project in Shanghai has become popular with tourists and locals alike, who are drawn to its narrow lanes, outdoor cafés, and tony boutiques.

ROCK BUND

This colonial district is being developed by New York's Rockefeller Group and planned by Wood. An art deco theater and 1930s buildings will become apartments, shops, and a boutique hotel.

Global Ambitions

China's largest city is the Asia headquarters of more than 150 multinationals, including GM, IBM, and Alcatel-Lucent. Other Shanghai facts:

POPULATION:

18 MILLION

HIGHWAYS:

347 MILES

CARS:

1.1 MILLION

CELL PHONE SUBSCRIPTIONS:

16.3 MILLION

STARBUCKS OUTLETS:

82

GDP PER CAPITA:

\$7,550*

FOREIGN INVESTMENT:

\$14.6 BILLION**,
23% OF CHINA'S TOTAL FDI

*2005 **Approved projects, 2006

Data: China Statistical Yearbook, BusinessWeek

Expatriates love Shanghai's night-life, while skilled young Chinese and migrant laborers have rushed to cash in on the city's surging economy. Shanghai is growing at 12%—even faster than the 10.7% expansion that China as a whole saw in 2006—and the city's gross domestic product was \$136 billion last year. That's less than half of London's, but Shanghai's growth is three times as fast the British capital's. And Shanghai has attracted some \$120 billion in foreign direct investment since 1992, including commitments of \$14.6 bil-

last year, or 23% of China's total FDI for 2006. "You are witnessing the greatest transformation of a piece of earth in history. It's mind-boggling," says Greg Yager, vice-president of Baltimore design firm RTKL Associates, which has done planning work in the city.

The opportunities in Shanghai have attracted scores of foreign architects, who have helped craft one of the world's most extraordinary skylines. In the financial district of Pudong, which until two decades ago was little more than rice paddies and small factories, the 88-story Jin Mao Tower (designed by Chicago's Skidmore, Owings & Merrill) is home to GM, Creditonnais, and IBM. Next door, the 101-story Shanghai World Financial Center (from New York's Kohn Pederson Fox Associates)—originally planned as the world's tallest building, but now eclipsed by Taiwan's Taipei 101—is about three-quarters completed. Across the Huangpu River, the 66-story Plaza 66 by Atlanta-based John Portman & Associates) houses General Electric, BP, and KPMG. And the once-dilapidated Bund, the old-time Wall Street of Asia on the riverfront, has been reenergized with packed nightclubs, tony boutiques, and trendy restaurants. "Shanghai is a dynamic, exciting, increasingly multicultural city," says Robert Pallash, president for Asia at auto-parts maker Visteon Corp., which moved its regional headquarters to Shanghai from Japan in 2003. One reason they won out over Bangkok, Hong Kong, and Singapore: It's easier to sell for expats. "It's very important to attract people from the global organization," Pallash says.

Attracting locals is equally important. The legions of mi-

grants flocking to Shanghai are filling Visteon's factories, as well as those of Intel, Philips, Honeywell, and scores of other multinationals. And the city's universities are churning out thousands of engineering grads every year, which provides a steady supply of researchers for labs run by corporations from around the world. At its facility in Zizhu Science Park, 18 miles southwest of the center, Intel Corp. now employs 1,000 people, up from about 40 in 2000. A decade ago, "it was difficult to find a high-quality office building," and qualified workers were scarce, says Wang Wen-hann, general manager of the lab. Today, "all these factors have matured," he says.

OVERSTRETCHED INFRASTRUCTURE

IN NEIGHBORHOOD AFTER neighborhood, though, eight-lane expressways and steel-and-glass behemoths crowd out gracious townhouses and tenements dating to the early 20th century. The city has doubled its housing stock over the past two decades, but most of those new homes are in soulless skyscrapers. And many of Pudong's towers stand alongside the 100-yard-wide Century Avenue, a thoroughfare that's nearly impossible to cross and lacks so much as a kiosk selling newspapers, let alone a sidewalk café. The district represents "a failure to create a livable urban environment," says Tom Doctoroff, the chief executive for Greater China at ad agency JWT Co.

That's a problem for a place with mega-ambitions. If companies find that Shanghai has become too pricey or too congested for the kinds of employees they want to attract, it may quickly fall from the global hot list. Top-quality office space today costs more than in Midtown Manhattan, and expatriates typically pay \$5,000 to \$10,000 or even more in monthly rent. The air can be unbreathable, and the highways are clogged much of the day. "You have a city whose infrastructure is totally stretched," says Steve Mullinjer, managing partner at executive search firm Heidrick & Struggles in Shanghai. "It's like a wild horse...with no way to rein it in."

Controlling that runaway horse is Job One in Shanghai, and how Shanghai grapples with that issue is important for all of China. Hundreds of millions of migrants are likely to move to the mainland's cities in coming decades, and much of the rest of the country looks to the city for cues. So if Shanghai bulldoz-

AZUI

is answer to meet sports one world's most popular skylines. The 101-story financial designed by k's William n, will join the

SHANGHAI 2010 EXPO

The city is spending \$8 billion to relocate 50,000 people and transform shipyards and steel plants into an exposition highlighting "21st century urban models."

QINGPU

This satellite city is building homes for 250,000 new residents. Wood is planning new housing along the district's ancient canals that fits in with its traditional architecture.



21st Century Icons

Shanghai has become a proving ground for ambitious architects from around the world

With 1.3 billion people, the mainland can ill afford the kind of suburban culture that many seem to want. "The government is now more aware of quality-of-life issues," says Daniel Vasella, chairman of pharmaceutical giant Novartis and head of the International Business Leaders Advisory Council for the Mayor of Shanghai. "They realize that if you can't deliver [a good standard of living], people won't want to live there."

Perhaps that's why the Chinese have taken so readily to Ben Wood. The 59-year-old architect, whose white beard and ruddy complexion make him seem more like a good ol' boy from his native Georgia than a hotshot designer, was drawn to Shanghai's street life and the crowded tenements known as *shikumen*. These two-story buildings, a *mélange* of Chinese and Western styles with carved stone details, had remained largely untouched since the Communists took over in 1949. But when Wood arrived in Shanghai in 1998 to design Xintiandi, they were rapidly being razed.

At the Xintiandi site, Wood suggested saving the structures and creating a walking district that would preserve the sense of community of old Shanghai. That was a revelation to the city fathers, who until then had struggled to find an alternate way of expressing Shanghai's newfound confidence and affluence. Having proved it can replicate the West in districts such as Pudong, the city was looking for a second wave of development that wouldn't just import styles wholesale, but could give shape to its aspirations as a world-class metropolis. Wood "understands the relationship between new and old buildings," says Wu Jiang, deputy director of the Shanghai Urban Planning Bureau.

If Wood has been good for Shanghai, Shanghai has been equally good to Wood. He kept a relatively low profile in the U.S., but in China he's a true star. Xintiandi's success has spawned countless imitators on the mainland, and Wood has

es its history to build highways, you can bet that many other cities will follow suit. Since 2000 the number of cars on the mainland has tripled, and Shanghai and Beijing are already ringed with single-family homes and new communities accessible only by car.

received more than a dozen major commissions. Today he runs a studio of 30 draftsmen and designers, and inquiries from prospective clients roll in almost daily. He is working on a mountain resort, a development similar to Xintiandi in the western city of Chongqing, and another in Hangzhou, lakeside city 120 miles southwest of Shanghai. Wood "is totally different from other foreigners practicing in China," says Mingyun, a Shanghai architect and now dean of the School of Architecture at the University of Southern California. "He is quite into the human side."

TRICKY POLITICAL LANDSCAPE

TO KEEP SHANGHAI'S GROWTH from tearing apart its urban fabric, the city is building nine new communities on the periphery that are expected to house a total of a million or more newcomers by 2020. These projects, called "One City, Nine Towns," were planned as self-sufficient satellite cities where residents can live, work, and shop, without having to travel into central Shanghai. Each was also designed thematically to resemble the cities of other countries or cultures—a notion some dismiss as frivolous. In Fencheng, for instance, a Spanish group is creating streetscapes inspired by Barcelona's Rambla promenade. Albert Speer, son of Hitler's favorite architect, is the brains behind Anting, a community modeled after small cities in Germany and home to the Shanghai Formula One circuit as well as Volkswagen's joint-venture auto factory. And Thames Town looks like an English village with cobblestone streets, half-timbered Tudor buildings, red telephone boxes, and a statue of Sir Winston Churchill. "It's farcical," Wood says. "Why pretend you are living in some fantasy land?"

Wood's contribution to the nine towns effort is less garish. In Qingpu, on the southwestern edge of Shanghai, he is working on an 830-unit residential complex that draws its inspiration from the area's ancient canals, bridges, and walkways. His aim, he says, is to create buildings on a human scale that relate to their environs. "The biggest problem in China is that the Forbidden City is burned into every brain," says Wood. "It's symmetrical, monumental, and out of scale."

China's modern-day mandarins can be equally intrusive. In 2004, Rockefeller Group International, the New York-based

« SHANGHAI WORLD FINANCIAL CENTER

101 STORIES

- Designed by New York's Kohn Pederson Fox
- To be completed 2008
- Originally planned as the world's tallest building but since eclipsed by Taiwan's Taipei 101. The original design had a circle carved out of the top, but was changed to a trapezoid after complaints that it looked like the Japanese flag.



JIN MAO TOWER

88 STORIES

- Designed by Chicago-based Skidmore, Owings Merrill
- Completed 1999
- With its pagoda-like shape and richly textured exterior, the Jin Mao is the most "Chinese" of Shanghai's skyscrapers; currently its tallest.

TOMORROW SQUARE

60 STORIES

- Designed by Atlanta-based John Portman & Associates
- Completed 2003
- This building, with apartments and a Marriott hotel, is a square tower that is rotated 45 degrees into a pincer-like spire. Said to have the world's highest library.



RADISSON SHANGHAI NEW WORLD

46 STORIES

- Designed by East China Architectural Design
- Completed 2005
- This hotel on Nanjing Road appears unremarkable until you see the roof, where a revolving restaurant looks like a just-landed UFO.



ORIENTAL PEARL TV TOWER

1,535 FEET

- Designed by Shanghai Modern Architectural Design Co.
- Completed 1994
- Built as a telecommunications tower, this icon is a top draw for Chinese tourists who love the views. There's also a shopping mall, a revolving restaurant, and a hotel.

property development arm of Mitsubishi, hired Wood to plan a 10-acre site the developers call Rock Bund. The project will incorporate a 1928 art deco theater and more than two dozen colonial-era buildings. Rockefeller seemed to have everything going for it, including the support of Shanghai Communist Party Secretary Chen Liangyu.

But in a city changing as rapidly as Shanghai, you never quite know when you might end up building on political quicksand. Last September, Rockefeller executives got a disturbing call from their lawyer, saying, "Our friend is in the gutter." The friend was Wu Minglie, the chairman of New Tangpu Group, a Chinese company that was working with Rockefeller. He had been detained and accused of misappropriating city pension funds for property development. Shortly thereafter Secretary Chen was sacked in what many believe is a power struggle with China's central leadership in Beijing. Rockefeller Group executives declined to comment on the word about the affair, which a company spokesperson calls "extremely delicate." Though most projects have been delayed since Chen's ouster, there's no indication that Rock Bund is in danger of being scuttled.

Despite the headaches, Wood isn't one to shrink from a challenge. A latecomer to architecture, he didn't start practicing until he was 36. By that time he had flown fighter jets with the U.S. Air Force and founded a mountaineering school and a French restaurant in Colorado. At 31, he enrolled in a graduate architecture program at the Massachusetts Institute of Technology. Wood soon started his own firm with Ecuadorian Carlos Zapata and broke into the big leagues in 1998 with a commission to build Soldier Field, the Chicago Bears' stadium.

When Wood was in the middle of the Soldier Field project, he got a call from Hong Kong. Would he pick up a business-class ticket waiting for him at the airport and come ASAP? Two days later, Wood was being whisked by limo to the offices of Vincent Ho, chairman of property group Shui-On. The meeting lasted 15 minutes. "He told me, 'I want you on the next plane to Shanghai and back here tomorrow morning,'" Wood recalls.

After a few hours wandering the dilapidated neighborhoods that would become Xintiandi, Wood returned to Hong Kong to make his pitch. He cited Boston's Faneuil Hall Marketplace and mountain villages in Italy as potential models. As luck

would have it, Lo was a fan of the Boston development and had spent time in Tuscany. "After half an hour, I said, 'This is the man I want to work with,'" says Lo, who gave Wood the job over three competing architects. Within six months, some 1,600 families had been relocated to new developments far from their old homes—not always happily, despite having indoor plumbing and their own kitchens for the first time. "We did things like take off their roofs to speed up the process," Wood says.

The irony of Xintiandi's success is that surrounding blocks have been bulldozed for luxury developments, spelling the end of the local charm that attracted Wood in the first place. Lo now wants to turn adjacent property into a theater district that will rival Broadway or London's West End. Although a few handsome brick buildings will be saved, the expanded site will also include four theaters, a 68-story office tower and high-end apartments. The outdoor dining, meanwhile, won't be at dumpling stands, but at upscale restaurants. "The real tragedy is not the disappearance of the [old buildings], but of life on the streets," Wood says.

As Shanghai's transformation continues apace, Wood is likely to be there to watch it unfold and lend a hand where he can. In 2003, he moved full-time to Shanghai, one of the few foreign architects to make such a commitment. On any given evening, you're likely to find him holding court in the DR Bar, a Xintiandi watering hole he designed and owns, or treating guests to grilled salmon and steaks in his two-story penthouse, followed by a soak in the outdoor hot tub with views of the city's ever-changing skyline. Will he ever go back to the U.S.? Don't bet on it. Shanghai's growth still offers plenty of opportunities, especially for an architect who understands that it takes more than tall buildings to make a truly global capital. "If Shanghai is unable to provide the quality of life of a world city like Paris or London, it will never become a major financial center," Wood says. "But the wild west atmosphere is being replaced by more sophisticated development strategies. And this will ultimately be to Shanghai's advantage." ■

BusinessWeek .com

ONLINE: For slideshows on Shanghai's changing skyline and the Nine Towns initiative, please visit www.businessweek.com/extras

A Dynamo Called Danaher

The Rales brothers' sprawling conglomerate makes everything—especially money

BY BRIAN HINDO

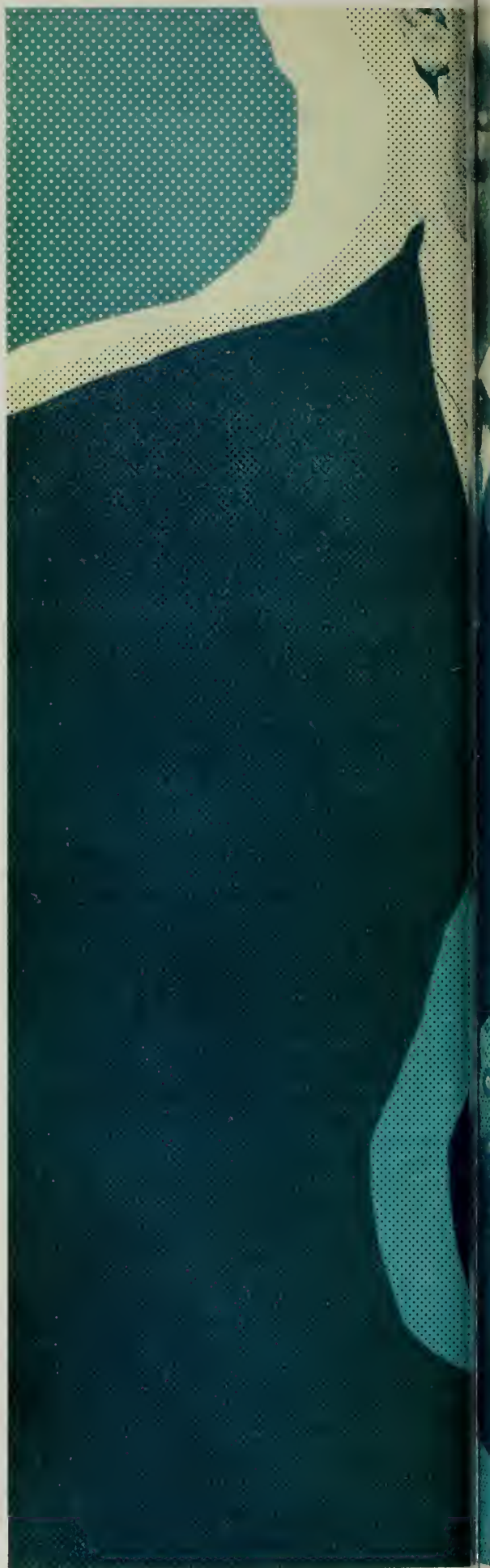
DANAHER CORP. IS not nearly as big, famous, or influential as conglomerates such as General Electric, Berkshire Hathaway, or 3M. It owns such a mundane and sprawling portfolio of sleepy, underloved industrial businesses—companies that make dental surgery implements, multimeters, drill chucks, servomotors, and wrenches, just to name a few—that it seems deliberately assembled to be as unsexy as possible.

But despite its low profile, Danaher is probably the best-run conglomerate in America. It's clearly the best performing: Over 20 years, it has returned a remarkable 25% to shareholders annually, far better than GE (16%), Berkshire Hathaway (21%), or the Standard & Poor's 500-stock index (12%).

The Washington (D.C.) company is the brainchild of the obsessively private brothers Steven M. and Mitchell P. Rales. The onetime corporate raiders, who have not spoken to the media in more than two decades, have pulled off an unusual corporate metamorphosis. They have turned Danaher from a mere acquisition vehicle into a true-blue, cash-producing, publicly owned industrial manufacturer. In the process, the Rales brothers have become two of the richest people in the U.S., worth more than \$2 billion apiece.

Unlike most other '80s-era raiders, Steven, 55, and Mitchell, 50, are so publicity-shy that it's almost impossible to find a photograph of them, alone or together. Many businesspeople have never even heard of them. But among both industrial and private-equity cognoscenti, their

Photo illustration from a 1988 picture of camera-shy Mitchell and Steven Rales





reputations are as big as their fortunes. "These guys are really good. There is no luck involved," says Mark D. Ein, a private equity investor at Washington's Venturehouse Group, who has known the Raleses for many years.

Steven and Mitchell Rales, who now serve as chairman of Danaher's board and chairman of its executive committee, respectively, declined comment. But in a rare interview, Danaher Chief Executive H. Lawrence Culp Jr. described the hard-charging business culture that has produced such remarkable results. In 2006, Danaher posted revenues of nearly \$10 billion and net profit margins of 16%, truly astounding for a company still in such Old Economy businesses as heavy-truck braking systems and hand tools. Its return on invested capital is 15%, way ahead of its industrial peer group, which is near 9%.

THE ANTI-BUFFETTS

SITTING IN DANAHER'S unassuming headquarters on the top floor of a glass office building (there's no sign announcing the company's presence), six blocks northwest of the White House on Pennsylvania Avenue, Culp sounded like a man who is hard to please. "There are a lot of companies where if you win 10-9, nobody wants to talk about the nine runs [they] just gave up," Culp says. "We'll celebrate the win, but we'll talk about 'How did we give up nine runs? Why didn't we score 12?'"

Think of Danaher as the anti-Berkshire Hathaway. Warren Buffett runs his empire like a benevolent curator. The Rales and their management team are "the polar opposites" of that model, says Ann Duignan, an analyst at Bear, Stearns & Co. These conglomerateurs have built their portfolio not by buying undervalued companies and holding them but by imposing on them the "Danaher Business System."

DBS, as it's called, is a set of management tools borrowed liberally from the famed Toyota Production System. In essence, it requires every employee, from the janitor to the president, to find ways every day to improve the way work gets done. Such quality-improvement programs and lean manufacturing methods have been *de rigueur* for manufacturers for years. The difference at Danaher: The company started lean in 1987, one of the earliest U.S. companies to do so, and it has maintained a cultish devotion to making it pay off.

BIOS MITCHELL P. RALES



COLLECTOR Mitch is on the National Gallery's board

AGE 50

EDUCATION BA, Miami University 1978; pledged Beta Theta Pi.

OUTSIDE INTERESTS Noted collector of modern and contemporary artists, including Mark Rothko and Willem Kooning. Turned his Potomac (Md.) into Glenstone Museum, an intimate art sanctuary.

DEPTH OF POCKETS Danaher holds worth approximately \$2.2 billion.

Even before a deal is done, the DBS team, made up of managers throughout the company steeped in training, works with the acquisition target to inject a heavy dose of Danaher DNA. Employees at the newly acquired companies, it can be a jarring experience. It wouldn't be at all unusual for a Danaher manager clutching a clipboard, a tape measure, and a stopwatch, in a search for wasted motion, to tick off how many steps a data analyst has to take to get to the copier. Danaher also isn't afraid to swing the ax; it has, at times, bought certain product lines and shuttered the rest of the company. "Those guys have a very well-defined model of how to do M&A," says Jim McTaggart, founder of strategy consulting firm Marakon Associates, now part of Trinsum Group. "They do the strategy well, they price [deals] in a disciplined manner, and they integrate these things superbly."

Danaher's portfolio—with more than 600 subsidiary companies—reflects a move away from its hand-tool legacy to more technologically advanced products. The newest of four units, accounting for 23% of sales, specializes in medical technologies. It includes Sybron, a dental-equipment maker, and Leica Microsystems, which makes high-end microscopes.

From Microscopes To Periscopes

Industrial conglomerate Danaher is made up of a vast array of unsexy businesses, more than 600 in all. Here's a look at where it gets its nearly \$10 billion in revenue:

INDUSTRIAL TECHNOLOGY 32.5% of sales Parts for industrial machinery, such as actuators, motors, and ball screws. Aerospace and defense units make ejector seats and submarine periscopes.	 Accu-Sort camera  Kollmorgen motor	PROFESSIONAL INSTRUMENTS 30.3% of sales Fluke manufactures test tools such as multimeters. Hahn and Trojan Technologies make water treatment systems. Gilbarco sells gas pumps.	 Fluke clamp meter  Hach Guardian Blue Event Monitor	MEDICAL TECHNOLOGIES 23.1% of sales The most recent strategic thrust, this unit includes Sybron, which makes dental tools, and Leica Microsystems, which makes high-end medical microscopes.	 Sybron Endo CT tips  Leica microscope	TOOLS & COMPONENTS 14.1% of sales Brands include Jobox industrial storage bins, Craftsman hand tools, Jacobs Chucks drill parts, and Armstrong for professional mechanics.
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Data: company reports, Friedman Billings Ramsey

STEVEN M. RALES



AGE 55

FAMILY Oldest of four brothers; father, Norman, was a successful real estate investor.

EDUCATION BA, DePauw University, 1973; played football and pledged Beta Theta Pi. JD, American University, 1978.

OUTSIDE INTERESTS Named to *ArtNews*' top 200 in 2006 along with brother Mitchell; recently began financing a forthcoming project by Wes Anderson, director of *The Tenenbaums*.

POCKETS Danaher holdings worth approximately \$2.2 billion.

pathology labs. Its most profitable division, professional instrumentation, includes Fluke, known to engineers for products such as multimeters. The company's industrial-tools division, though it only accounts for about 14% of sales, houses Danaher's most well-known brand, Craftsman hand tools. The rest of Danaher's business comes from industrial technologies, including machinery components and product-ID devices, such as Accu-Sort package scanners.

The Raleses didn't set out to build an empire. In the early 1980s they took a former real estate investment trust, turned it into a leveraged-buyout vehicle, and swashbuckled through the next few years, tacking assets on to their shell company through hostile bids, greenmail, and junk-bond financing. Michael R. Milken's Drexel Burnham Lambert and Citicorp Boston as their bankers. They even crossed swords with Ted Leonsis, who swooped in as the white knight buyer of ailing consumer-products company Scott Fetzer Co. after Danaher tried to snatch it.

GOOD COP/BAD COP

ALTHOUGH THEY WERE NEVER flamboyant, their brash dealing rubbed some people the wrong way. A 1985 *Forbes* article headlined "Raiders in Short Pants" suggested the Raleses were "callow youths," "more like real estate speculators than industrialists," and "cocky to the point of foolishness." Neither Steven nor Mitchell has spoken to the media since.

By the mid-1980s, with the leveraged buyout market tanking and the fledgling company struggling under a heavy debt load, the Raleses changed course. After a group of managers in one of the divisions, Jacobs Vehicle Systems, found early success by mimicking Toyota Motor Corp.'s lean manufacturing, the brothers decided to implement the Toyota system companywide.

Within a year, Danaher was reborn as a bona fide operating company. Soon after, in 1990, the Raleses ceded daily control to a chief executive, George M. Sherman, whom they hired away from Black & Decker Corp. Danaher, then and now, makes plenty of acquisitions, but it barely uses any debt to do so, even as the LBO market has swung back into favor. It's not that the company is debt-averse all of a sudden. It's the luxury of \$1.4 billion in free cash flow.

Although they have long worked in tandem, Steven and Mitchell have distinct managerial personalities. "Steve is more strategy-oriented," says Friedman, Billings,

Ramsey Group Inc. analyst Ned Armstrong. "Mitch is more operations-oriented." In practical terms, says ex-Danaher executive John A. Cosentino Jr., that meant "Steve was sort of the good cop and Mitch was the bad cop. If someone needed a course correction, Mitch might do that talking."

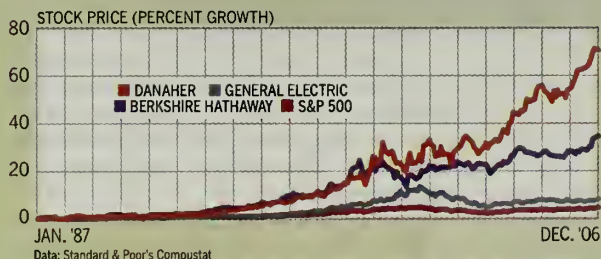
Despite their lack of industrial background, the Raleses had a near-instinctive affinity for lean manufacturing, say ex-managers. The process breaks from the traditional "batch-and-queue" manufacturing system, in which big lots of product are assembled in discrete steps. In a lean environment, a company moves a smaller flow of items through production. Wasteful steps are easier to spot. And if a mistake creeps into the process, it won't affect a huge amount of inventory and can be fixed quickly.

In a typical Danaher factory, floors are covered with strips of tape indicating where everything should be, from the biggest machine to the humblest trash can. Managers determine the most efficient place for everything, so a worker won't have to walk an extra few yards to pick up a tool, for instance. The lean attitude permeates the culture at Danaher—only 40 people work in the Washington corporate headquarters, at a company of 40,000.

Danaher takes great pains to instill its values in new employees. New managers are often sent to Japan, where they soak up the attitude of *kaizen*, or continuous improvement. In fact, Culp

TRACK RECORD

Danaher has outpaced bigger, better-known conglomerates such as Berkshire Hathaway and GE. Here's a look at its performance over 20 years.



himself, fresh from Harvard Business School, started his tenure in 1990 at Danaher's Veeder-Root Co. unit by spending a week in Japan building air conditioners in a lean manufacturing plant.

Despite the company's early success at mimicking Toyota's operational acuity, the Raleses didn't seek distinctions like the Shingo Prize for Excellence in Manufacturing or the Baldrige Quality Award. "There was an active strategy of keeping it under the radar," says former Jacobs Vehicle president George Koenigsaecker, who now runs a private-equity firm, Lean Investment, in Muscatine, Iowa. They had two good reasons. First, according to former managers, the Raleses worried others would notice their results and copy the strategy. Second, they didn't want to be raided for talent.

Former Danaher executives credit the Rales brothers for having the smarts and self-confidence to cede daily company responsibility. Still, the two have influence over Danaher's direction and hold about 20% of the shares. Culp and his directors talk about strategy regularly, although the Raleses don't come into the office often. Nor do they sweat the day-to-day minutiae.

Steven and Mitchell have turned to other pursuits. In addition to Danaher, the brothers also control Colfax Corp., a

PLAYBOOK

M&A The **Danaher** Way

Lessons from a prolific, successful acquirer

FILL THE PIPELINE Always be on the prowl for deals. Danaher never lacks for ideas and doesn't have to do defensive mergers.

STAY DISCIPLINED Don't get emotional at the negotiating table. If the price gets too high, Danaher walks away.

INTEGRATE WELL Danaher adds value to acquired companies, using its "Danaher Business System" to boost performance.

Data: BusinessWeek, Trinsum Group

smaller, privately held conglomerate that hasn't shied away from using debt to pursue growth. Equity Group Holdings, the Raleses' private equity arm, shares space with Danaher on Pennsylvania Avenue. Both brothers are art enthusiasts and philanthropists. Mitchell, who was named a top 10 collector by *ArtNews* in 2003, recently turned his Potomac (Md.) estate, which housed a number of animals, including alpacas, into Glenstone Museum, a private art sanctuary. Steven has recently begun financing movies.

OPENING UMBRELLAS

DANAHER HAS REACHED a crucial point in its short history. As revenue creeps toward \$10 billion, its market cap has moved past \$20 billion. The outfit's goal, set by Culp in the 2002 annual report, is to hit \$25 billion in sales by 2012. At current growth rates, it's on track. But of Danaher's average annual 20% sales growth in the past five years, about 14% has come through acquisitions. As M&A gets more expensive, Danaher must either increase the pace of its deals or swallow bigger fish. And it may be more difficult to convert bigger companies with established traditions, entrenched cultures, and larger workforces to its fervent brand of lean manufacturing.

Danaher is a prolific acquirer, averaging about a deal per month. Most are small to midsize and supplement existing businesses. Danaher considers bigger deals, but only if they create new umbrellas under which more deals will fall. Fluke, for one, was a \$625 million foray into more tech-intensive instruments.

Some analysts have raised eyebrows at the sizable goodwill on Danaher's balance sheet—\$6 billion worth. But they haven't been any writedowns that would call into question the price paid for an acquisition. Part of the reason, perhaps, is the company's exacting, unsentimental M&A process. Before a deal, Danaher executives tour plants and search for ways to improve performance. They estimate how wide an acquisition target's profit margins could get, given the Danaher treatment. "They allowed us sometimes to bid more on an acquisition because we knew we'd get that value back," says Mark C. DeLuz, president of Lean Horizons Consulting, who used to spearhead Danaher's DBS team.

When it bought Fluke in 1998, margins were 8%, much thinner for Danaher. As part of the team that managed the acquisition, Culp sought to boost that number to 20%. Many employees at Fluke, which had an engineer-centric culture where many good ideas got funding, said that couldn't be done without hurting quality and innovation. But under Culp, Fluke narrowed its product focus, sped up inventory turns, and reduced floor space. Now, margins in that segment are 21.5%.

In recent years, Culp has tried, with limited success, to steer organic growth to investors. Interruptions as opposed to acquisitions, growth has been chugging along at a respectable 6% a year or so for the past few years. But that's not why the company has such a high price-earnings ratio: 18 times trailing earnings, vs. 17 for 3M. One of the few Danaher bears, Prudential Equity Group analyst Nicholas Heymann, cites concerns over organic growth as a reason for his "underweight" rating. As Duignan of Bear Stearns puts it: "I think the biggest risk is that the acquisition pace slows because of competition."

So far, that hasn't happened. The company's pipeline is well stocked; Danaher walks away from more deals than it consumes. Its managers are determined not to lose their reputations for price discipline and rigorous execution. Of course, a continued ascent into the rarefied air of large conglomerates carries one big risk: It makes publicity-shy Danaher and the Raleses the more conspicuous for their success. ■



CULP The CEO worked his way up the ranks



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An Analyst On the Attack

Richard Greenfield is an exception:
demanding and effective activist

ROBEN FARZAD

WHEN WALL STREET struck its \$1.4 billion settlement with regulators in 2002, the deal was supposed to herald a new era for independent research. The big brokerages shed brick walls between analysts and clients, and independent research shops popped up everywhere.

But for all that reinventing, the analyst path of least resistance still reigns. "We're trimming our estimate by a penny while maintaining our intermediate-term, 12-month equal-weight rating, with a going-forward bias toward being aggressively neutral," a typical research note might read. There's good reason for the caution (and the kind of scatory language that would rankle Mr. Brown's teacher). Even independent analysts rely on executives for news and information; alienating them would be a bad career move.

But Richard S. Greenfield of Pali Research stands out in the sea of noncommittal analysis by making pointed demands, the sort you hear from an activist hedge fund manager. "I invest time and effort only where I think I can make clients money," he says. "Can we be activist? Absolutely."

Cablevision Systems Corp.'s controlling Dolan family found themselves in Greenfield's chairs in October, after attempting to take the company private for a share price of 27, a 5% premium over where the stock was trading. Greenfield thought the company could go as high as 40 if it opened up to outsiders, and he urged management to task pub-

licly. The Dolans, he argued, were positioning themselves to snag an extra \$1.8 billion profit by flipping the company to Time Warner after taking it private. Sensing dissent in the boardroom, he urged the special committee of directors to seek a takeover price of 35, while upping his target twice based on the improving industry. The Dolans came back with a "best and final" offer of 30.

Many viewed the sweetened deal as a *fait accompli*. "A lot of the analysts were just resigned to the Dolans getting their way," says a big stockholder. But Greenfield re-emerged to blast out a note entitled: "Do Not Let Chuck and Jim Dolan Steal Cablevision." He argued that the Dolans were "exercising poor corporate governance by publicly stating they would not sell the company [to outsiders]." Cablevision's committee turned down the bid four days later, and the stock shot above 30—vindicating Greenfield's claim the Dolans were holding it back.

Being a sell-side analyst usually entails a daily drip-drip of updating earnings models and issuing commentary on most every company in an industry. Now, like the rash of institutional investors who take positions in companies and rumble



BATTLER Recent targets include Viacom and Cablevision

for change, Greenfield, a former Goldman Sachs analyst, is picking his battles.

Another recent target: Viacom Inc. In a July note, Greenfield lamented that no one at the lagging media conglomerate was "willing to stand up, communicate a concise global vision...and execute on that vision." Then he mockingly bulleted Viacom's "excuses" for poor growth before basically calling for the head of then-Chief Executive Thomas E. Freston: "If Mr. Freston cannot swiftly reorient Viacom, [the board] needs to find a new CEO and/or consider selling the company."

Two weeks later, Greenfield put out a note directed to Chairman Sumner M. Redstone titled "Dear Mr. Redstone: Take Viacom Private." When Redstone ousted Freston in September, Greenfield kept up the pressure, putting out recommendations tinged with an "I'm-watching-you" tone.

Last year he also flagged DreamWorks Animation SKG Inc. for allowing its majority investor to benefit from the falling stock price, and the IPO of Vonage, which has since plunged 70%. Says Greenfield of his MO: "If I'm not excited about the stock or feel I can't make a difference, then I'm just not going to cover it." The Dolans wish he didn't cover theirs. ■

DUELING THE DOLANS



Data: Bloomberg Financial Markets

Where Dell Went Wrong

In a too-common mistake, it clung narrowly to its founding strategy instead of developing future sources of growth



BY NANETTE BYRNES
AND PETER BURROWS

AT DELL, HOW IT ALL began is never forgotten. Even on Jan. 31, as founder Michael S. Dell returned to the role of CEO after 18 months of bad news and faltering financials, the press release trumpeted how, 23 years ago, Dell launched what would become a \$56 billion business with just \$1,000 and a simple idea. That stroke of genius—to bypass the middleman and sell custom-built computers directly to the customer—was one of the revolutionary business models of the late 20th century. Rivals from Hewlett-Packard Co. to IBM learned to fear its power. And once Dell began using the Internet to let customers configure their own PCs, no phone rep required, the company earned a place among other champions of the New Economy including Wal-Mart, Cisco, and Southwest Airlines.

Dell's storied beginnings have given way to another classic business tale, one far less happy. Like many long-forgotten former champions, Dell succumbed to complacency in the belief that its business model would always keep it far ahead of the pack. While Dell broadened its product line, it never dealt with the vast improvement in the competition or

used its lead in direct sales and the cash generated to invest in new business lines, talent, or innovation that could provide another competitive edge. "Dell is a textbook example of single-formula growth: 'We make PCs cheap. This is what we do, and we do it a lot,'" says Jim Mackey, managing director at the Billion Dollar Growth Network, a research consortium focused on large-company growth. "You can grow very fast when you're on a single formula, but when you get to a certain point, you don't have the ability to create new growth."

Long-term success demands constant reinvention. Research done by Mackey and others shows that most fast-growing companies hit a point somewhere over \$50 billion in revenue at which they falter. By then, growing apace demands billions of new sales every year. Rarely is the original, unchanged business model up to the job. The only way around the challenge: Nurture the next growth platform long before it's needed.

Most don't. Distracted by the demands of their current success, they are lulled into a false sense of security. "When it's all you can do to keep

up with the growth your current business model is providing, you just don't feel that urgency," says Harvard Business School professor Clayton Christensen. "It's hard to get worried." He visited Dell's Round Rock (Tex.) offices in 1999 and again in 2000, and warned Dell's then-CEO Kevin Rollins that they needed to focus on growth five to eight years out on the model that would augment their built-to-order machines. A great admixture of both men's intellect, Christensen says, he naively hoped they would take his advice. Instead, Dell pushed its model into new types of hardware, such as storage printers, and TVs, in the hopes of making easy profits by selling products made by other companies. In some areas, like printers and TVs, the customization that made a Dell PC seem special isn't a factor. In others, like services, low-cost competitors had a head start.

Dell focused on giving Wall Street what it wants: The highest possible earnings

Michael Dell maintains that his company's business model is its key advantage. Dell, he says, has acquired too much middle-aged fat and lost the internal focus and drive that made it an icon. In an internal e-mail explaining the recent departure of CEO Rollins, Dell



DELL He still sees his business model as a key advantage

under promised that the company will customer support problems, boost services business, and focus more on all and midsize outfits in addition to megacorporations that bring in the of sales. While he won't rule out strategic shifts, such as a move into I, Dell says: "I do think that Dell's strengths historically will be its core ngths in the future."

Many critics say the problem is that company didn't begin a more orderly ution when times were better. For a decade, it was the only major PC pany that earned a profit. By cutting the middleman and keeping research development and inventory costs it often enjoyed profit margins 10 its higher than money-losing rivals. er than use that cushion to develop n capabilities, Dell gave its admirers Wall Street and in the media what they t: the highest possible earnings. ubris crept in. In 1999, Dell bought startup called ConvergeNet, which a sophisticated storage product that ed out to be not ready for prime time. bing rival EMC Corp. the "Excessive gin Company," Dell seemed to expect age to follow the same pattern PCs moving from pricey, feature-laden els into a standards-based commod-Dell underestimated the competition is an also-ran in the segment.

By 2005, PC rivals, particularly HP, which has taken the market-share lead from Dell, had closed the efficiency gap and were enjoying resurgent sales at retail stores.

PEOPLE-INTENSIVE

DELL'S LOYALTY to its business model could make it difficult to recapture growth. Dell has suggested a new offensive to enlarge its computer services business, which so far has focused largely on repair and upgrading of Dell's hardware. According to Bill Scheer, senior analyst at Kennedy Information Inc., which tracks information technology consulting, such "hardware" services are the slowest-growing segment of the \$147 billion market, currently increasing an estimated 6.3% a year, vs. 7.6% for the market overall. Hardware repair profits can be good, but don't lead to the massive deals that help sell higher-end hardware and software to tie it together.

Consulting experts say Dell will have a hard time moving up the value chain. For one thing, it's a people-intensive business that doesn't benefit from the company's expertise in efficient manufacturing. And when Dell first started making PCs, it entered an industry with lots of built-in fat,

namely reseller commissions and retailer markups. Lower-end consulting has already been made far lower-cost and more efficient by companies like Wipro Ltd. and Infosys Technologies Ltd., which sell programmers' time at \$50 a hour that 10 years ago would've billed at \$125 an hour or more.

Dell has struggled to find other growth areas large enough to matter. After a promising start in printers, moving quickly to No.3, the most recent quarterly data from research firm IDC shows Dell's market share at 3.6%, down from 6.2% the previous year. Its once-promising move into networking gear has fizzled, and its share in the storage systems market is flat compared with a year ago.

And Dell's management bench doesn't seem as deep as it should be. When Dell ousted its chief financial officer on Dec. 19, the company ended up filling the spot with an outsider, board member Don Carty, the former CEO of AMR Corp., the parent of American Airlines. Industry sources say many of the recent management departures were not terminations but rather people burned out by an increasingly dismal turnaround effort. Dell spokesman Bob Pearson says the company has good bench strength and "we feel fortunate that [Carty] could do this."

These are the kinds of challenges Dell was protected from for years. How well its founder handles them will determine whether his legacy is building a great company that lasts—or having a great idea that ran out of steam. ■

—With Louise Lee in San Mateo, Calif.

Second Thoughts

In the 1990s these companies rewrote the rules of business. But their big ideas have undergone a reassessment.

	WHAT WE THOUGHT THEN	WHAT WE THINK NOW
DELL	Merchandise sold directly by phone or the Internet would replace bricks-and-mortar stores.	People like live shopping, even for technology, and bad service makes them angry.
WAL-MART	The king of discounters had conquered supermarkets. Next, the world.	The Wal-Mart way hasn't translated well into all markets.
SOUTHWEST AIRLINES	The hub-and-spoke system was history, and discount airlines, hopping from airport to airport, would rule.	The Old Guard has risen from bankruptcy court, while Southwest's stock is in a holding pattern.
ENRON	"Asset-light" trading strategies can be applied to almost any market.	It's a far more limited idea than the Enron guys would've had you believe.
CITIGROUP	Sandy Weill had created a financial supermarket for the newly democratic world of investments.	Laser-focused traders and bankers at Goldman Sachs make out by sticking with lucrative investments.

Steve Jobs Changes His Tune

Why he's willing to jettison industry restrictions on copying music and video

Apple Chief Executive Steven P. Jobs stunned industry watchers on Feb. 6 when he urged the music industry to rethink its most fundamental antipiracy strategy. With the blessing of music companies, Apple's iTunes music store has thrived under a "digital rights management" system (DRM) that restricts how, when, and where users listen to the songs they purchase.

Now, in an apparent about-face, Jobs has called for a new model in which songs would be bought and sold without these DRM constraints. Here's why his pronouncement is causing such a stir:

What's behind Jobs' call for change?

Apple is under pressure from European governments to remove digital rights management technology from its iTunes Store so audio can be played not just on its dominant iPods but also on music players from rivals. Consumers have also complained that they should be able to do what they want with music they purchase.

What's all the fuss about DRM?

Consumers today have the ability to make pristine copies of music and video and distribute them over broadband connections in a matter of minutes or hours. Without restrictions on copying, content providers say they could be put out of business.

And why is it such a mess for consumers?

The biggest problem is the lack of a single, worldwide DRM standard that works on every device and download service. Right now, music purchased from Apple's iTunes store can be played on any combination of five iPods or computers, but not on any other music players. This is especially irksome when you have to lose or retire one of your legitimate devices. And under some DRM schemes, there are time limits. For ex-



Consumers want to do as they wish with the music they buy

ample, you may only be able to view a downloaded movie for 24 hours after the first time you play it. Even if you are using only one service, the software may be buggy and confusing. This is all a huge step down from the world of com-

pact discs, where you just buy the music, play it in any stereo, PC, or car system, and copy it as many times as you like.

Doesn't the very idea of digital rights management treat all people as if they were thieves?

It's not quite that bad. Many content providers believe consumers are entitled to fair use of their products, so they don't think people have an absolute right to do whatever they want with them once the money changes hands. Many providers are experimenting with pricing models that would charge a consumer based on intended usage, with some paying more for unlimited use.

But what's the point—haven't pirates and hackers managed to break all DRM schemes anyway?

As Jobs points out, all software can be cracked. Music labels themselves never seem to realize that the lack of a stan-

dardized DRM is hurting their sales. But while DRM has not stopped rampant piracy, it has helped slow it. A world with no DRM could be very tough for many businesses. Everybody loves free stuff, but the lost revenue could put some content providers out of business. They are testing a world-supported revenue model, but pay-per-view models, like DRM remains a necessary evil until new models are in place.

Is there an alternative that could be used today?

The leading alternative at the moment is electronic watermarking, which allows content to be played anywhere but permits copies to be tracked to their source. It would be more onerous

for content providers that need to do the tracking, but it would create more choice for honest consumers.

If DRM goes away, how would Apple and Steve Jobs benefit?

Jobs' standing as a major advocate of the consumer could rise, even though Apple continues to tie its hardware closely to software and services. With or without DRM, Apple comes out looking like a winner.

—Cliff Edwards in San Mateo, Ca

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How Gilead Primed the Pipeline

Its \$2.5 billion purchase of Myogen offers instant diversification from its HIV drug focus

BY ARLENE WEINTRAUB

THERE WAS PLENTY OF head-scratching on Wall Street last October when Gilead Sciences Inc. announced it would spend \$2.5 billion to acquire Myogen Inc., a smaller biotech company. Myogen's annual sales are just \$7 million. Its lead experimental drug will address only a tiny group of patients with a rare form of hypertension, and its second-most-promising drug faces an uncertain path to market. Myogen's shares soared 50% after the October announcement, while Gilead's fell 10%.

On Feb. 2 investors put Myogen concerns on the back burner after Gilead announced record annual revenues of \$3 billion, up 49% from 2005, and profits that jumped 51%, to \$1.2 billion, before acquisition charges and other expenses.

Gilead is enjoying robust demand for its new HIV drug Atripla, a pill that combines three treatments in one. Its stock soared 11%, to 71, on the earnings report. Such performance has landed Gilead on the BusinessWeek 50 list of top-performing large companies two years in a row.

The acquisition of Myogen, based in Westminster, Colo., will help answer a question that has been dogging Gilead for years: How can a company that derives 80% of its sales from HIV drugs keep growing at double-digit rates? In the first nine months of 2006, Gilead spent just 13% of revenues on research and development—a level more typical of a stodgy Big Pharma company than a forward-thinking biotech. Myogen, along with a smaller acquisition Gilead made last year, offers instant diversification. Myogen researchers are devel-

GILEAD LAB Its low R&D spending has worried investors

oping drugs to treat respiratory and heart disease, giving markets with huge

potential payoffs. "In one swoop, Gilead solved the pipeline problem," says JPMorgan biotech analyst Geoffrey Meacham.

Myogen's most advanced experimental drug, called Ambrisentan, treats pulmonary arterial hypertension (PAH) disease that strikes up to 1,000 people per year, causing severe breathing problems and, ultimately, heart failure and death. "It hits people in the prime of their lives," says Gilead CEO John Milligan, adding that he hopes Ambrisentan will turn PAH from a death sentence to a chronic disease, much as Gilead's other drugs have done with HIV/AIDS.

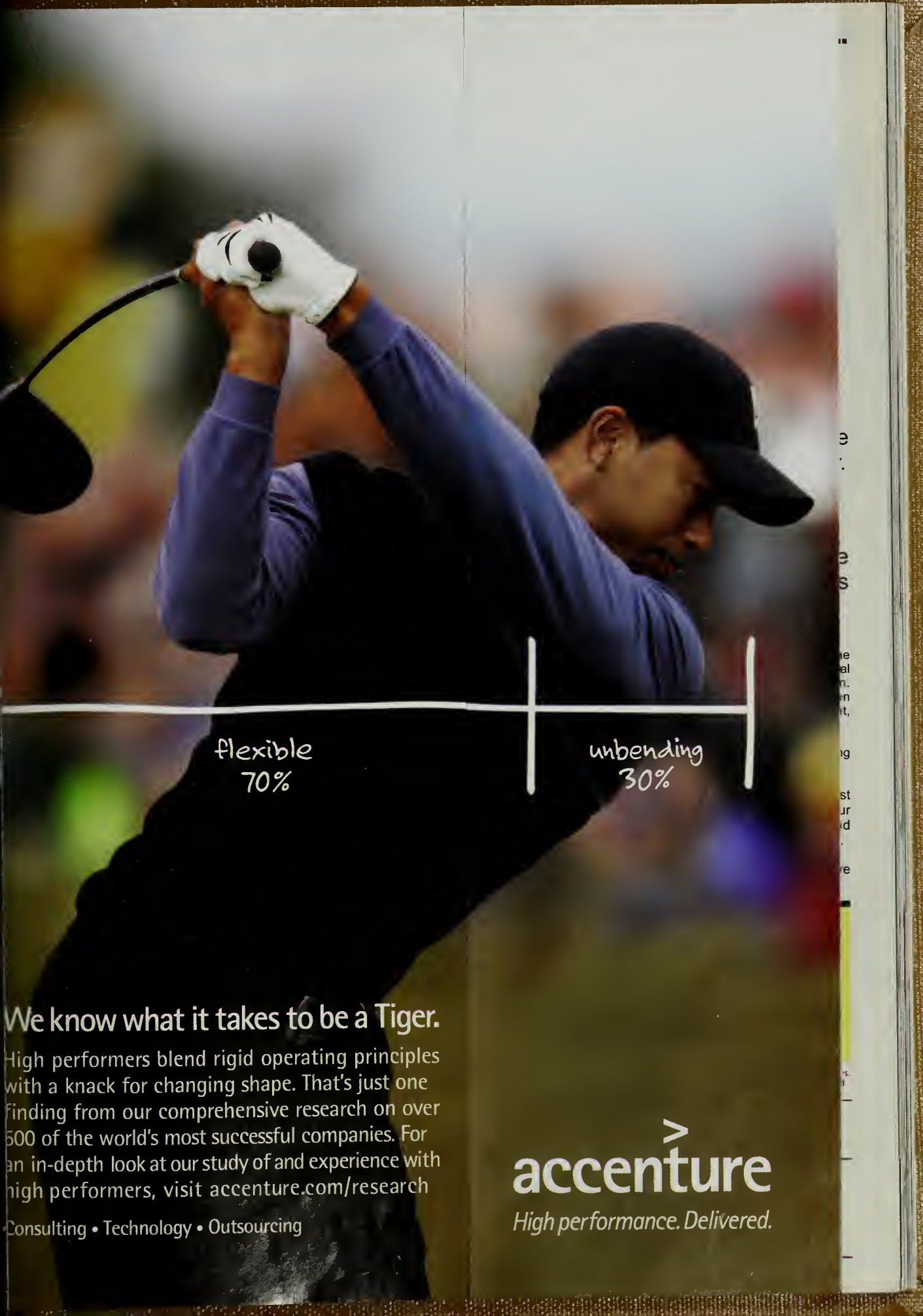
GOLD MINE?

AMBRISENTAN MAY BE a niche product but its advantages over existing drugs could make it a gold mine. Current PAH treatments can be toxic to the liver and sometimes clash with other drugs. The risks "may be substantially lower with Ambrisentan," says Dr. Lewis J. Rubin, professor of medicine at the University of California at San Diego. Rubin treats patients as part of a clinical trial for which he received consulting fees. Gilead expects a verdict from the U.S. Food & Drug Administration later this year. Analysts estimate the drug could ultimately bring in annual sales of \$500 million.

If Gilead can clear some hurdles, it could have an even bigger opportunity with Darusentan, a Myogen drug being tested in patients with uncontrollable high blood pressure. More than 2 million patients aren't helped by current drugs and are at risk of heart attack and stroke. Analysts estimate that Darusentan could be a billion-dollar hit. But the FDA is requesting that patients in the late-stage trial take the drug along with four other blood pressure treatments, all at the full doses. Most patients balk because such a regimen makes them feel sick. "It will be extraordinarily hard to enroll patients. So this is not a viable drug right now," says Gilead CEO John Milligan. Gilead is weighing alternative trial designs.

Investors who need reassurance that Gilead is not totally reliant on HIV drugs can look forward to trial data that the company expects to release this year for three hepatitis drugs and a cystic fibrosis treatment. Putting an exclamation point on its commitment to long-term growth, Gilead just opened a two-story lab that will house 100-plus scientists.





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INNOVATIONS

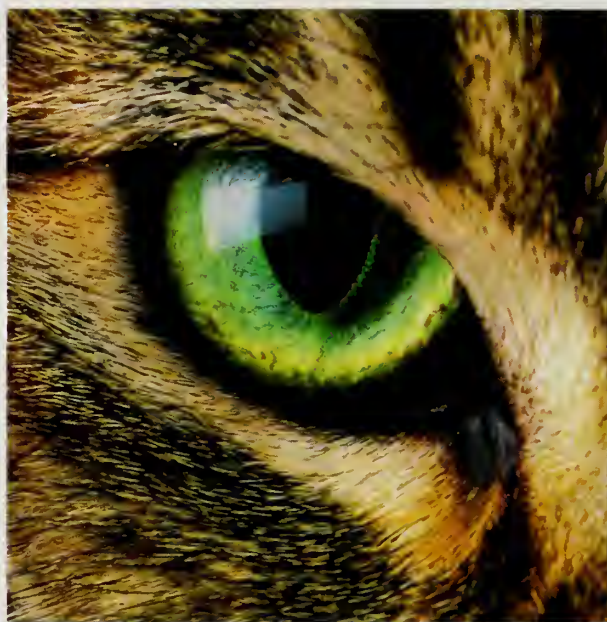
Of compact biorefineries and risky smells

▶▶ The military is always interested in ideas that will reduce the amount of diesel fuel and waste that soldiers must cart around. So Purdue University engineers have come up with a tactical biorefinery that solves both problems. About the size of a small van, it separately processes different kinds of trash—food waste, paper, and plastic—into biofuels. Food scraps are fermented into ethanol in a bioreactor, while paper and plastic are refined into fuel that can be burned in a diesel engine to power an electric generator. In tests last fall, the biorefinery produced 90% more energy than it consumed.

▶▶ Scientists have shown that slashing calories can extend your lifespan, at least if you're a fruit fly. But be careful what you sniff. Experiments conducted at Baylor College of Medicine in Houston suggest the faintest whiff of food may be enough to lessen the benefits of caloric restriction. When the scientists exposed batches of long-living, calorie-starved flies to yeast smells, their lifespans shrank significantly. The smells had no impact on well-fed flies, which continued to live out their normal, short lives. The implications for human beings are unclear.



(CLOCKWISE FROM BOTTOM LEFT) EYE OF SCIENCE/PHOTO RESEARCHERS INC.; JEFF SMITH/ALAMY; STOCKBYTE/CORBIS



VISION THING CAT'S-EYE MARVELS

IN ADDITION to acting eerily human, cats have something important in common with people: their eye structure. So a team of scientists at the University of Missouri at Columbia is using cats to test tiny implantable microchips that could one day treat patients with retinitis pigmentosa, a disease that causes progressive sight

loss. The chips contain thousands of diodes that convert light into electrical signals, which then stimulate still-healthy cells so they can better transmit visual information to the brain. This summer, the scientists will study the cats' behavior to determine how much their sight has improved.

—Arlene Weintraub

SEA BREEZES PLENTY OF POWER JUST OFFSHORE

A SUPER WEAPON in the fight against climate change is blowing just off the coast. In waters stretching from North Carolina to Massachusetts, there is enough wind power to replace all of the region's fossil-fuel power plants and more, says a new study from the University of Delaware and Stanford University. In reaching this assessment,

the group excluded deepwater and off-limit zones, such as shipping lanes and spots visible from tourist beaches. Their model showed 330 gigawatts of potential wind power, or four times the area's existing generating capacity—plenty to heat and cool buildings and to power electric cars for everyone. Offshore energy could help the region's 63 million people cut greenhouse gas emissions by 57%, says team leader Willett Kempton, a professor of marine policy at Delaware.

—Adam Aston

PHARMACO BEAMING —TO SPOT FAKE PILLS

FRAUDULENT DRUGS place lives at risk and cost the pharmaceutical industry billions each year. The Food & Drug Administration estimates some 10% of all drugs sold are phony, and the percentage may be higher. Yet it's difficult to spot the fakes, in part because elaborate tamper-proof packaging is hard to get at sample test them.

Now scientists say they have a way to tell: a "chemical fingerprint" through the plastic packaging that encases the pill. It's a variation on a technique called Raman spectroscopy, and it works by focusing a laser



millimeters beyond the pill's packaging to spot the chemicals that make up the medicine itself. Older laser techniques were "like trying to find a candle against the sun," explains Pavel Matousek, a research scientist at Rutherford Appleton Laboratory in Didcot. The new process was developed by focusing the laser on a darker background. The process could also help spot explosives hidden in packages.

—Eric

Producing a new symbol of excellence in international mining...

antam



are Antam, we find, make and export valuable metals to customers around the world and our performance, growth plans and market capitalization* keep getting better.

It was time for a better logo.

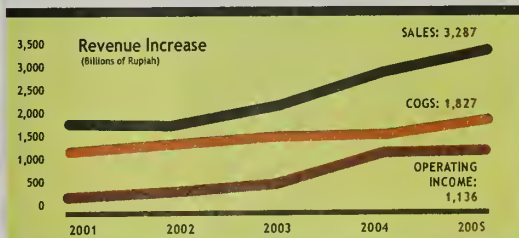
are proud to present our new logo which more accurately reflects where we are now and where we are going. This change is part of the many exciting developments opening at Antam.

Our new logo is composed of three mountains, representing the rock/mineral source and diversity of Antam's products. The mountains themselves rise from an arc which represents nature with the reflection of the three mountains representing the mineral resources inside the earth. This logo represents a modern dynamic, environmentally responsible and community caring Antam. The symmetrical shape of the logo and the style of the logotype conveys a sense of harmony, stability, strength, and solidity, even friendliness. As well, the logo captures many of Antam's attributes such as mining, diversified, established, professional, prudent, trustworthy, progressive, dynamic and open.

Antam's President Director, D. Aditya Sumanagara said, "we trust our new logo will become a symbol of excellence in the mining and metals processing sector, for everyone from our customers and suppliers, to our local communities and to our shareholders"

We are a vertically-integrated diversified, financially sound, growth-oriented, mining and metals company with vast reserves spread throughout the mineral rich Indonesian archipelago. We are listed in Australia and Indonesia and our shareholders have come to know the value we can deliver, in terms of dividends, profit growth, wide margins and good returns. Our share price has outperformed similar companies and the Jakarta Composite Index for the past three years.

We are experts of mining and metals processing, are expanding our operations and should all go according to plan, we will make more money in 2006 and still more in 2007.



* "Mine Indonesia 2005", PricewaterhouseCoopers, 2006. The average net margin in 2004 was 15% for the Top 40 Global mining companies and 19% for Indonesian mining companies. The average return on equity in 2004 was 19% for the Top 40 Global mining companies and 27% for Indonesian mining companies. Antam beat the industry in terms of margins and returns.



Fully Listed in: Indonesia: (ANTM) / Australia (ATM). This communication is not an invitation to engage in, nor advice related to, any kind of investment activity. It is for information purposes only. Queries related to investment activities should be addressed to a licensed broker.

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antam



Soaring Where Boeing Struggled

How spin-off Spirit AeroSystems built a new model for worker-management cooperation

BY STANLEY HOLMES

FOR UNION WORKERS, A new corporate owner usually means one thing: mass layoffs. So it comes as quite a surprise that, after buying Boeing Co.'s Wichita aircraft plant, the Toronto private investment firm Onex Corp. kept on most of the 4,000 employees.

Of course, the Machinists union wasn't

The comity between Spirit management and the International Association of Machinists & Aerospace Workers is partly a sign of the times. The commercial plane business is booming, which is why Spirit expects to post a 2007 profit of \$260 million on projected revenues of \$4.1 billion, up from about \$3.2 billion in 2006. That won't last forever. But for now the unusual deal is being

INNOVATION CASE STUDY

weak assets and outsource more of manufacturing work, decided to sell uncompetitive Wichita plant. Although it was Boeing's biggest internal supplier, cranking out fuselages and nose cones, it suffered from inflexible work rules, low wages, and testy labor relations.

Enter Mersky and fellow Onex Managing Director Nigel S. Wright. When Boeing executives saw lemons, the turnaround specialists saw lemons. They reasoned that if they could cut costs, make the plant more productive and start working for Airbus, defense contractors, and regional jetmakers, the Wichita plant could become profitable.

But first Onex had to get control. The firm saved \$40 million annually by slashing corporate overhead costs inherited from Boeing. It negotiated price reductions from Spirit's suppliers and simplified the procurement process. It managed to reduce the complexity of work by reducing 160 job classifications to 13. Finally, it asked the unions for a 10% wage cut to better reflect the prevailing wage in the area and told them it would reduce the workforce by 15%.

SHARING THE PAIN

ONEX, WHICH SOUGHT the union's support, lost the first vote with the Machinists. Many workers came from third- and fourth-generation Boeing families and wanted to stay with the giant. "It's tough on people," said Ron Eldridge, Machinists' aerospace coordinator in Wichita. "It was like an ugly divorce." The managing directors approached R. Thomas Buffenbarger, international president of the union. "They ask 'What's it going to take?'" Buffenbarger recalls. "I said, 'If you want to share some of the pain, then give us a stake in the enterprise.' They warmed to it quickly."

A new deal was negotiated: For wage and job cuts, Onex offered union members a 10% equity stake in an eventual IPO. The new owners sketched out a scenario where workers could earn \$30,000 in stock and cash over five years as long as the IPO was successful.

Now, 18 months later, the bargain exceeded everyone's wildest dreams. The IPO on Nov. 21 raised \$1.4 billion. The Machinist is about to receive \$61,441 in cash and stock. Given Boeing's backlog of orders, plus a surge of defense-related spending, analysts figure Spirit's stock will do well in the next few years. "I should buy the company goodwill when the industry hits the skids." ■



JET PARTS Machinists at the Wichita facility

happy that more than 800 people lost their jobs. But the new owners helped ease the pain by giving the remaining workers \$246 million in cash and stock options. The money was a reward for helping the company, now named Spirit AeroSystems, cut costs and pull off a successful initial public offering. "I can't tell you what a thrill it is to give our organized workforce nearly \$250 million," says Seth M. Mersky, an Onex managing director.

widely praised as a promising new labor model. No one is more bullish than the man who helped put it all together, former Democratic House Minority Leader Richard A. Gephardt of Missouri. "It is what we are going to have to do in a lot of our industries to be globally competitive," says Gephardt, who is a consultant with Goldman, Sachs & Co. "It aligns [workers] with the company and gives them a fair reward for their contribution."

This improbable story began several years ago, when Boeing, in a bid to shed



ventional wisdom would tell you small farms can't operate as
ciently as large ones. But in Poland, Cargill is going beyond the
ventional to help small livestock farmers compete. Large farms in
ope have traditionally had the advantage of feed delivery services
e small producers must travel to dealers to buy the few bags
require. So Cargill worked with feed dealers to bring the store to
farm, on trucks that efficiently deliver small feed orders on a regular
chedule. The dealers get new customers and farmers get service they
er thought possible. This is how Cargill works with customers.

laborate > create > succeed™



HOW DO YOU EFFICIENTLY DELIVER
FEED TO A FARMER WHO KNOWS
ALL HIS ANIMALS BY NAME?



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Hot News In Nowheresville

Fortress' GateHouse Media is snapping up small-town papers—and turning a nice profit

BY TOM LOWRY

FOR THE PAST YEAR OR SO, private equity firms have spent tens of billions of dollars acquiring some of America's most storied businesses. Fortress Investment Group, meanwhile, has been doing due diligence in places like Sleepy Eye, Minn., Heber Springs, Ark., and Canandaigua, N.Y. Quietly and methodically, the New York private equity firm has assembled the largest collection of small-town newspapers in the U.S.

Through GateHouse Media Inc., Fortress controls more than 400 publications, from Michigan's Upper Peninsula to the California desert. This year the company is expected to generate \$23 million in net earnings on \$400 million in revenues. GateHouse went public in October, raising \$248 million, before Fortress, which still holds a 60% stake, resumed gobbling up local papers.

Given the parlous state of the newspaper industry, sinking money into print may seem contrarian, crazy even. But as national chains are broken up and young

readers and advertisers flee to the Web, Fortress has spotted an anomaly: There's good money to be made publishing newspapers in small towns and exurbs.

These are places where readers are loyal and plentiful. And local advertisers are keen to reach them. GateHouse's growing grip on local advertising dollars could soon be giving big dailies headaches in some markets. It also could put a crimp in plans by Yahoo! Inc. and Google Inc. to colonize the local ad business. Yet GateHouse lacks the scale of a giant like Gannett Co. But its local papers generate margins of up to 40%, double that of some big-city dailies. "These newspapers are the dominant media in their towns," says GateHouse Chief Executive Michael Reed. "That's why we never look at a market and say it's too small."

Fortress' newspaper play marks its first foray into the media business—the firm hired Reed for his experience running an Alabama-based newspaper chain. Nine-year-old Fortress, which itself is in the midst of going public, owns seven public companies, including the jet-leasing outfit Aircastle Ltd. and Brookdale Senior Living Inc., a national chain of retirement communities.

'These newspapers are the dominant media in their towns'

FAITHFUL READERS

In Waynesboro, Pa., 70% of the citizenry reads *The Record Herald*

Fortress declined to comment for this story, but it has a reputation for holding and managing companies for the long haul—and paying decent dividends. Peter Appert, a Goldman Sachs Group Inc. analyst who has a buy rating on GateHouse, notes this is unusual in the private equity world. "Others haven't duplicated this widely," he says.

From the start, Fortress has gone after publications with little or no competition and then bolted them together in regional clusters. Doing so lets Fortress to cut costs by consolidating back-office operations and use the savings to build a strong online presence. In June, 2005, Fortress made its first move, purchasing Liberty Group Publishing Inc., a Northbrook (Ill.)-based publisher of small-town newspapers, from Hard Green & Partners. The deal got a lot of attention at the time—which was fine by publicity-shy Fortress. But the acquisition became a key building block as the private equity firm began constructing its newspaper empire.

What did Fortress executives see that many didn't? For starters, they noticed a medical and technology services boom was drawing thousands of people out of Belt towns that had once seemed

terminal. Take Honesdale, Pa., a former railroad hub. There, a major hospital expansion and flourishing office parks have supercharged the local economy. Meanwhile, the area has become an admittedly distant suburb of New York City. Today the region boasts the state's fastest-growing population. Fortress owns a daily there called *The Wayne Independent* and a weekly, *The News Eagle*.

Fortress noticed that these places, despite their rapid growth, fell into something of a media no-man's-land. The big dailies and network TV didn't provide much in the way of local coverage. Meanwhile, the cable and phone companies so far have deemed it insufficiently profitable to roll out broadband in some of the more remote towns. So people rely on the local rag, and in hamlets like Devils Lake, N.D., and Waynesboro, Pa., 70% of the people are reading it. By contrast, a big-city daily is lucky to get 40% of the market.

BUNDLING THE HYPERLOCAL

HENCE, GATEHOUSE'S so-called hyperlocal strategy. Editorially, that means if a fistfight breaks out at the school board meeting, the news goes on the front page. Pee Wee football? Huge news, especially for parents hoping their ball-spiking kid gets major play on the sports page. *The Bastrop Daily Enterprise* in Louisiana recently featured a front-page story about a man who won a radio station contest and a trip to the Grammy Awards.

Big papers have been losing national advertisers to cable TV and the Internet, and classified listings to the likes of Monster.com and Craigslist. But local hardware and grocery stores rely on the hometown paper to advertise their price specials. "We are in a town of 10,000, and the local paper is maybe 8 to 10 pages. People will read that," says Randall Jones, a dentist in Arkadelphia, Ark., and a regular advertiser in the *Arkadelphia Daily Siftings Herald*. "Our message would be lost in a larger newspaper."

GateHouse is going after regional advertisers as well. For example, 125 of its local publications, including *The Patriot Ledger* in Quincy, Mass., now form a

ring around Boston. GateHouse can offer an advertiser, say Macy's, a package deal for all its Boston-area newspapers and Web sites. Look out, *Boston Globe* and *Boston Herald*.

For the time being, Google and Yahoo present no real challenge to GateHouse because they lack sales reps in Small-town, USA. Not that Fortress is taking any chances. It's starting to publish its online content under Creative Commons licenses, whereby copyrights are waived and anyone can pick up stories for noncommercial use—a boon to local bloggers. Reed says making content freely available will bring more eyeballs, attract new advertisers, and allow it to raise rates.

As Fortress continues to add to the GateHouse empire and consolidate operations, there is always the temptation to take an ax to newsroom operations. Clear Channel Communications Inc., after all, vowed to stay local when it was rolling up stations in the late 1990s, only to homogenize lots of programming to save a buck. "Good journalism is our duty," Reed contends. "If we don't do that, we know we will lose our readership in buckets."

Journalists have heard this before, of course—most recently from Brian P. Tierney. He bought up Philadelphia's newspapers and vowed to do good journalism, but ended up laying off dozens of reporters and editors. Fortress seems less likely than its private equity counterparts to cash out quickly. And it may have bought peace with GateHouse shareholders; in October, Fortress issued an annual dividend of \$1.28—not bad for a stock trading at about \$19.

Still, the company needs to keep the deal machine revved up. GateHouse must generate sufficient cash flow to pay down \$560 million in debt (a debt-earnings ratio that's twice the newspaper industry average), continue to invest in new Web initiatives, and keep those dividends coming. CEO Reed will be spending a lot of time on the road, scouring the country for deals. They shouldn't be hard to find. Fully 8,000 daily and weekly newspapers still roll off the presses in the U.S. And many do business in the outposts that GateHouse considers its sweet spot. ■

Extra! Extra! Private Equity Loves Local

After buying a local newspaper company 18 months ago, Fortress Investments has been on a tear. Its holdings now include:

75
DAILIES

231
WEEKLIES

230
LOCAL
WEB SITES

117
SHOPPING
GUIDES

2
BUSINESS
DIRECTORIES

Data: GateHouse Media Inc.

A Villa of Your Own

Thanks to the Internet, European vacation rentals from Tuscan

YOU'VE JUST finished a leisurely gourmet dinner, washed down with the best local wine. Now you and your guests are enjoying coffee on your terrace overlooking...a Tuscan vineyard? A lavender-scented Provençal hillside? The Aegean or the Costa Brava?

Living like this—for a week, anyway—has never been easier. For decades, Europeans have planned their summer holidays around a rented vacation house, whether a humble country cottage or a luxurious villa staffed with cooks and housekeepers.

Instead of bouncing from one hotel room to the next, they settle in for a nice long stay to unwind and soak up the local ambience.

Before the Internet, this quintessentially Old World experience required considerable resourcefulness or money to plan from afar. But now, tens of thousands of European properties, once advertised only by word-of-mouth or in local-language publications, are listed on English-language Web sites. A bevy of rental agencies with names such as “Tuscan Dream” and “Villa Vacations” has sprung up to service fast-growing demand. Without leaving your desk, you can browse through photos, compare prices, read



other travelers' reviews, and book the vacation rental of your dreams.

The hard part is knowing where to start looking. “It’s really daunting,” says Kathy McCabe, editor of travel newsletter *Dream of Italy* (dreamofitaly.com). “You could say ‘Tuscany,’ but

there are something like six different areas in Tuscany.”

Before starting your search, consider a few basic questions. Town or country?

A secluded country estate may lose its charm if you have to drive 20 minutes to buy your morning croissants

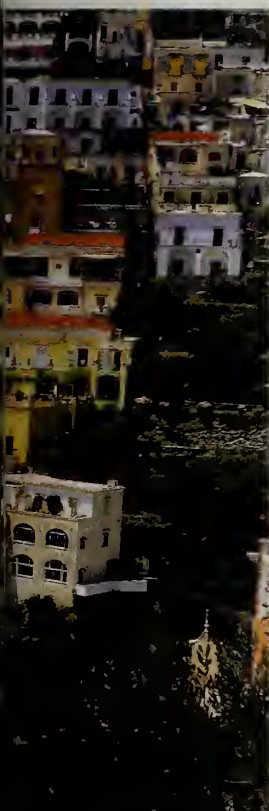
or two hours to the nearest museum. Coastal or inland? If you absolutely must have a beach nearby, count on paying at least 50% more than for a comparable hotel an hour’s drive inland. “On the Côte d’Azur we’re talking a minimum 15,000 euros [about \$19,000] a week for

ROBERT HARDING PHOTOGRAPHY/PUNCHSTOCK;
INSET: COURTESY HOLIDAY RENTALS



...n-for a Week

Positano Brava are easier to find from afar. **BY CAROL MATLACK**



ITALIAN HOLIDAY
Waterfront rentals often cost 50% more than inland properties; (below) a Positano villa



a three- or four-bedroom house," says Janette Gimbirt, managing director of the Royal Villas Europe, which handles upscale rentals around the Mediterranean (royalvillaseurope.com).

Most experts advise first-timers to book through a travel or vacation-rental agency. "An agency will work with you to determine what you are looking for," while offering extras such as booking tours or hiring a chef to prepare your meals, says Pauline Kenny, founder of slowtrav.com, a Web site offering tips, travelers' reviews, and classified ads for European rentals.

How do you choose an agency? Reputable ones should be willing to supply references from previous renters. They should also provide numbers you can call for English-language assistance in case of emergencies such as plumbing and electrical problems. If you've already pinpointed the region where you want to rent, find an agency specializing in that

area, which will probably have a wider selection of offerings and better-informed staff.

Sure, agencies charge extra. That's why more seasoned travelers often rent directly from owners who offer their houses online, often while listing the same property through an agent who rents it for 50% more.

France has an especially well-organized system for such rentals, or *gîtes*—a term that covers everything from converted garages to châteaux. Stu Dudley, a retired software executive from the San Francisco Bay area, has rented 22 *gîtes* over the past decade, including properties with swimming pools and drop-dead gorgeous views for less than \$1,000 a week. More than 44,000 houses are listed on gites-de-france.fr. The site has an English version, and you can search houses by location, price, and amenities. Most can be booked online. The downside of renting directly from owners: the higher potential for unpleasant surprises, from a lumpy bed to a noisy nearby road.

Almost all European properties are rented on a weekly basis, from Saturday to Saturday. Although dishes and cutlery are supplied, household items, such as toilet paper and soap, and kitchen basics, such as salt and coffee, usually aren't. You sometimes have to rent towels and bed linens, and you usually pay extra

for a cleaning service at the end of the rental. Most European villas have neither air conditioning nor window screens, so do research on the local climate before choosing when and where to rent.

Some surprises are pleasant. A house I rented in France's Dordogne region was next door to a cave decorated with prehistoric drawings of human and animal figures. The site wasn't listed on local tourist maps, but a small sign in front of the gate directed us to the house of the caretaker, an elderly neighbor who sold us tickets for the equivalent of a few dollars and let us inside to look around.

With a bit of planning, you can join the growing corps of satisfied renters. People who have rented, Dudley says, "never want to do the hotel thing again." One big attraction for Dudley and his wife is the chance to prepare meals with foods bought at local French markets.

Don't delay if you're considering a rental for this summer. Choice properties are often booked up a year in advance. So pour yourself a glass of wine, boot up the computer, and start surfing. ■

—With Daniel Carlin in Paris



BusinessWeek .com

ONLINE: For tips on renting in Europe, go to www.businessweek.com/extras.

TELEVISION: Looking for a summer rental in the U.S.? Watch *BusinessWeek Weekend*.



BY MIKE MARRONE

Two Voices that Command Attention

IN MY SIX YEARS at XM Satellite Radio, I have been involved in numerous live sessions. Each time, I asked the artist to do a recorded introduction of his or her favorite songwriters and singers for future use. More pieces of audio at my channel are labeled “Introducing Patty Griffin” than “Introducing [Anyone Else].” I think Steve Earle said it best on a fan Web site, pattygriffin.net: “I suspect Patty Griffin’s songs make most people a little uncomfortable—

like they’ve just walked in on a private moment in someone else’s life and they know they should turn around and tiptoe away, but they can’t. They make me jealous.”

Children Running Through is Patty’s fifth studio album release since her striking 1996 debut, *Living With Ghosts*. Although Patty has been nominated for two Grammy Awards, her name is still not widely known to the general public. But most people have certainly heard a few of her songs. The Dixie Chicks, Martina McBride, Linda Ronstadt, Mary Chapin-Carpenter, Bette Midler, and Emmylou Harris (who guests on this release) have all recorded versions of her material. Her music has also been used in television and film, including Cameron Crowe’s 2005 film, *Elizabethtown*.

Whenever my father caught Ella Fitzgerald on television he would say: “I would pay money just to listen to her sing the phone book.” I feel that way about Patty Griffin. Her voice is like a hurricane wrapped in velvet. From the sassy and subtle funk of *Stay on the Ride* on the new album to the stark, heartfelt drama of



FORCES Many artists have recorded Griffin’s songs. Gardot’s following is growing

Burgundy Shoes and the delicate beauty of *Railroad Wings*, her phrasing and command leave you holding your breath at the end of the song, whether she is belting it out or whispering in your ear.

PATTY GRIFFIN
Children Running Through
ATO RECORDS
.....
MELODY GARDOT
Worrisome Heart
SELF-RELEASED

Patty co-produced *Children Running Through* with Mike McCarthy. In addition to Emmylou, former Faces piano player Ian McLagan sits in on two highlights: the first single, *Heavenly Day*, and gospel-tinged *Up to the Mountain (MLK Song)*, in-

spired by Dr. Martin Luther King’s final speech. If you have never heard Patty Griffin sing her songs, don’t wait any longer. This just might be her final work to date.

TWENTY-TWO-YEAR-OLD Melody Gardot came to my attention through work with Phil Roy (BW—Nov. 20). Finding somewhere between jazz and blues in a place where Billie Holiday meets Tom Waits, she also has moments that recall pieces of Nina Simone, early Rick Lee Jones, and even the sophistication of Cole Porter. Only two years removed from a devastating traffic accident (a

bicycle was hit by a car that has left her in need of a cane and dark glasses), Melody has channeled her recovery into a remarkable mature recording, *Worrisome Heart*. Songs such as *Quiet Fire*, *All That I Need Is Love*, *Love Me Like a Revolution Does*, and the title track have been causing our request li-

to swell, and there are plenty more highlights on the set. Go to melodygardot.com for music and video samples, as well as the full story of this promising new artist. ■

Mike Marrone is program director of XM Satellite Radio’s *The Loft*, a channel that focuses on an eclectic mix of singer-songwriters from the 1960s through the present.



BY ROBERT PARKER

From Russian River With Love

M DEHLINGER, who has been fashioning wines in Sonoma's Russian River region for over three decades, remains one of Northern California's most unassuming winemakers. A true friend of wine lovers, he makes high-quality wines that sell at fair prices. Like many of the finer California winemakers, Dehlinger markets to select distributors, top restaurants, or to the public via mailing lists. Visit his Web site, dehlingerwinery.com, for information on purchasing the wines.

2004 Chardonnay Estate

92 points. A light green/gold color is accompanied by orange and lemon aromas, crushed rock, white currant, and spring flower characteristics. Full-bodied and rich with wonderful acidity, it keeps its fruit and minerality in the foreground, and the oak component (100% new) is well concealed by the wine's flavors. This beauty should age nicely for three to four years or more. \$32

2003 Syrah Goldridge Vineyard

92 points. The dark ruby-colored wine has a big nose of blackberry, saddle leather, and meat aromas. Medium- to full-bodied, soft, and supple, it is immediately accessible. Enjoy it over the next five to six years. \$35

2004 Pinot Noir Goldridge Vineyard

92 points. The dark-ruby-hued wine shows the cherry/pomegranate side of this Pinot Noir. Spicy and medium-bodied with abundant fruit as well as complexity, it should age well for seven to eight years. \$39

2003 Syrah Estate

92 points. This wine exhibits excellent concentration as well as nuances of acacia flowers and meat. With a terrific texture, loads of blackberries and glycerin, and a heady finish, it should drink well for seven to eight years. \$39

2003 Cabernet Sauvignon Estate

92 points. There are only 450 cases of this inky blue/purple-colored beauty. Aromas of

blackberries, blueberries, licorice, chocolate, and espresso are followed by a dense, powerful yet elegant cabernet that is reasonably light on its feet. Sweet tannin and fabulous concentration suggest it will age well for 15 or more years. \$42

2004 Pinot Noir Estate

91 points. Full-bodied and intense with superb elegance, complexity, and texture, it reveals abundant black fruits in the nose along with hints of forest floor, herbs, and earth. It should drink beautifully for a decade. \$43

2004 Pinot Noir Reserve

94 points. This small cuvée (just 250 cases) was produced from hillside vineyards. There's a sweet midsection, admirable ripeness, acidity, purity, and texture. This elegant effort has a medium- to full-bodied palate, loads of black raspberry, plum, and black cherry fruit, notions of forest floor, and a hint of oak. It should age nicely for a decade or more. \$60

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.



DEHLINGER
Tom and Carole
in their vineyard

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/extras.

It's All In the Timing

Sure, you could score big by riding the market's trends—but even the pros fail to do it regularly.

BY CHRISTOPHER FARRELL



HERE'S AN OVERWHELMING ARGUMENT for market timing (the legitimate sort, not the unseemly practice that got some mutual fund companies in serious trouble a few years ago). We asked Ibbotson Associates, the Chicago financial research firm, to see how much \$1,000 invested in 1926 would be worth today if the money were always in a broad basket of stocks in months the market went up and in Treasury bills during the others, with dividends and interest reinvested. The answer: \$30 trillion, vs. a mere \$3 million if the \$1,000 were invested in stocks and remained untouched. Far-fetched? Well, \$1,000

placed in the Standard & Poor's 500-stock index a decade ago would now be \$2,244 for the buy-and-hold investor, but \$14,561 for the prescient market timer.

It all sounds wonderful, in theory. These soothsayers are trying to pick the optimal entry and exit points by measuring data that are generated within the market itself, such as changes in prices and trading volume. They're not scru-

tinizing balance sheets or parsing economic fundamentals. They enact their trades in a variety of ways, using mutual funds, exchange-traded funds, and stock-index futures. Scores of professional timers, most of them mom-and-pop businesses, hawk their get-in, get-out advice to individuals on the Internet, cable TV, and through direct mail.

But the gap between perfect timing and

reality is huge. In fact, 2006 should have been a timer's dream since there were powerful trends to ride: up in the spring, down in the summer, up at yearend. Consider the 100 market-timing newsletters followed by *Timer Digest*. The top performer, Mark Leibovit of VRTrader.com, beat the S&P 500 by just 4.5 percentage points (table). William Ferree Jr., the next best, topped it by 3.4 points. Timothy Leary, the 10th best, was a point behind the S&P 500. (The *Digest's* returns do not include dividends and interest.)

The top 10 *Timer Digest* numbers are a bit better over a five-year period. Leibovit placed second in that race (up 57 percent) bracketed by Dan Sullivan of *The Clutist* (91%) and Christopher Cadbury of Cadbury Timing Service (42%). The remaining seven on the list were mediocre to worse, relative to the S&P 500's 28 percent price gain during the same period.

That's before taking into account



owed and trading costs. Since mar-
 iming can involve rapid shifts in
 olio positions, both costs can be
 (although taxes aren't a problem in
 sheltered retirement plans). Profes-
 sional timers sell their prognostications
 ly through newsletters and online
 ces priced between \$200 and \$1,000
 r. Many manage client money, too.

RP DROP-OFF

DATA GENERATED by longtime news-
 analyst Mark Hulbert of the *Hulbert*
cial Digest are different. But the result
 uch the same. Hulbert looked at the
 d of 103 market-timing strategies over
 past 10 years. Several did quite well
 pared with the 8.3% average annual
 in the S&P 500 (table). For instance,
 Brinker's *Marktimer* recorded a 13.7%
 alized return. But here again, the 10th
 timing system only gets you slightly
 r than the S&P 500 return. Hulbert

interprets the data as confirming his 80/20
 rule: 80% of timers fail over any reason-
 able period of time. He adds that the per-
 formance numbers got a boost from a bear
 market in the early 2000s. "Bear markets
 make market timers look like geniuses be-
 cause they have some money in cash," says
 Hulbert. Most mutual funds, for instance,
 stay nearly fully invested in stocks, so take
 a hit during bear markets.

What do the more accomplished tim-
 ers have to say about the market now?
 Leibovit, for one, is guardedly optimistic.
 Based in Sedona, Ariz., the veteran timer
 uses a number of proprietary indicators.
 "I think 2007 will be an O.K. year with a
 lot of volatility, and on balance, the mar-
 ket will be up until the fall," he says. "I'm
 not too happy with the market after the
 fall and going into 2008. Be careful."

On the other hand, veteran market
 seer Joseph Granville, the eighth best in
Timer Digest's five-year rankings, already
 is far more bearish. He confidently pre-
 dictes the Dow Jones industrial average
 will plunge to 7,100 from its current
 12,666. "It will completely surprise Wall
 Street," say Granville. The octogenar-
 ian, based in Kansas City, Mo., achieved
 celebrity status decades ago when he cor-
 rectly pegged the 1977-78 bear market.
 His reputation suffered after wrongly
 predicting a 1982 market crash.

Interestingly enough, though individ-

These Are the Champions?

One hundred market timers
 report their returns to the
 newsletter *Timer Digest*.
 Here are the 10 best for
 2006. Only four beat the
 S&P 500. (Returns do
 not include dividends or
 interest income.)

	Return
MARK LEBOVIT VR Trader VRTRADER.COM	18.69%
WILLIAM FERREE Ferree Market Timer (727) 736-2053	17.51
JEFF WEBSTER Investment Sense INVESTMENTSENSE.COM	13.94
STEVEN CHECK The Blue Chip Investor WWW.CHECKCAPITAL.COM	13.70
S&P 500 INDEX	13.62
*MARK BUWEN Monthly Market Prospectus MARKET-PROSPECTUS.COM	13.62
*DAN SULLIVAN The Chartist THECHARTIST.COM	13.62
*FARI HAMZEI HAMZEIANALYTICS.COM	13.62
*WILLIAM CORNEY No-Load Portfolios (702) 871-4710	13.62
*JAMES STACK InvesTech Research INVESTTECH.COM	13.62
TIMOTHY LUTTS The Cabot Letter WWW.CABOT.NET	12.68

*Tied

Data: *Timer Digest*

ual timers can easily err, there is some
 merit to their collective wisdom. *Timer*
Digest, for instance, gets recommenda-
 tions from its 100 or so timers each
 week and draws a consensus—bullish,
 bearish or neutral—from the week's top
 10. According to Hulbert's figures, one
 of *Timer Digest's* systems produced an
 11.3%-a-year return over the past de-
 cade, besting the S&P 500 by a full three
 percentage points. The other was just a
 shade behind, at 11.1%. Most professional
 investment managers would kill for those
 kinds of long-term results. ■

WOODWARD

After 50,
switching fields
may make sense



You're Older? So Sell Your Wisdom

Ageism is real, but you can beat it by emphasizing your skills and building relationships

AGE DISCRIMINATION IS against the law, but highly qualified people in their 50s and 60s still get passed over for jobs they might have landed easily if they were 20 years younger. Jeannette Woodward, 65, a former university library director who wrote *Finding A Job After 50* (Career Press), says you must get interviewers to look past the crow's-feet and appreciate why your experience and maturity make you the best person to hire. From her home in Lander, Wyo., Woodward spoke to Associate Editor Amy Dunkin about strategies for doing just that.

How is finding a job different when you're not far from retirement age?

This isn't a time to do it the same way you always have. You don't want to end up in the same rut. Make sure it's a job you want. You need to start over and think about what's really important to you.

How do you do that?

Think about how much money you need.

Are you burned out? Do you want a major change in occupation or where you live? Many people would be happier if they changed direction. Someone in my book did a total turnaround when he was 57. He went back to school and got a PhD in English. He wanted to do that in his 20s but people told him that he wouldn't be able to make a living. He wound up working for many years in city govern-

ment in a very responsible job when some newcomers came. He realized that he was terribly happy. He's now teaching English at a university and he really enjoys being in the classroom again.

Is there an unspoken bias against over-50 workers?

Oh, yes. I'm not sure that all managers are hiring them in order to discriminate. But when another person comes along, that's the person who comes to mind. They may think about older people like their parents, and managers would rather not have to supervise their parents.

How do you overcome that bias?

The attitude an applicant brings into a job interview is important. You don't want to treat a manager as a "sonny boy" or talk about

all the last 26 jobs you've had. You need to focus on your skills, to make it clear you have just the right ones for this particular job.

Does how old you look matter?

Yes. As you hit your 50s, one day you look 40, the next day you can look 60. During your interview you want to be the day you're looking as close to 40 as possible. Get a good night's sleep. Make sure your outfit and hair are up to date. Try not to lumber around when you walk or look arthritic when you sit in a chair. You need a quick, energetic step.

How else can you deemphasize age?

Make your résumé as neutral as possible. Don't put down dates for your education or go back more than 15 years on your work history. You don't want to call attention to the fact that you were in the work world since 1966. Once you establish a relationship with the interviewer, you'll have less difficulty with age prejudice.

Is there an upside to job hunting when you're over 50?

What's happening in most industries as baby boomers retire, they're leaving a hole in the workforce. If managers can't fill the jobs because they can't find the type of people they're looking for, they might be open to older people. Even if salaries aren't great, you may be able to negotiate things that are more important to you: flextime, more vacation time. You're looking for the job of your dreams, and sometimes you can help structure it.

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Helping Trusts Keep the Faith

Unitrusts can honor an estate's goals and boost income to survivors. **BY LYNN O'SHAUGHNESSY**

PENNY KAPLAN'S HUSBAND, Edward, came from a close-knit New York family that was bound together by a real estate business. But after Edward died suddenly of an aneurism more than five years ago at age 44, the relationship between Penny and her in-laws began to unravel.

Much of the discord centered around a \$14 million trust Edward had set up, \$8 million of which was tied to the family business. Kaplan had expected the property to throw off considerable income, but that hasn't been the case. Her father-in-law and sister-in-law, Kaplan says, insisted the businesses weren't generating any cash. (Another part of the trust, a \$6 million portfolio of mainly municipal bonds, is yielding about \$178,000 a year for the widow.) "This is very emotional," Kaplan laments. "My hands are tied financially." The in-laws' attorney declined to comment.

Trusts can't be broken, but it has gotten easier to squeeze more money out of them. Kaplan petitioned the Surrogate's Court in Nassau County, N.Y., to convert Edward's trust into a "unitrust." That little-known

vehicle would entitle the mother of two college-age children to receive 4% of the value of the entire trust annually, bumping up her total yearly income to roughly \$560,000. That might mean her in-laws would have to manage the real estate differently or even sell all or part of it to get the cash needed to pay her. "In this case, the unitrust is a way to get money to the surviving spouse," says Kaplan's attorney, Stephen J. Silverberg of Certilman Balin Adler & Hyman in East Meadow, N.Y. The unitrust can be a godsend to many trust beneficiaries, he adds. "We're starting to recommend it more and more."

Besides New York, 19 other states allow for a unitrust conversion, which typically locks the trust into generating 4% in annual income. That figure is used in most states because it should provide a fair return to current beneficiaries while preserving enough of the capital to allow the trust to grow for the next generation.

The unitrust is part of a larger movement in legal circles to bring trust law into the 21st century. The idea is that even trusts set up years ago can be modified

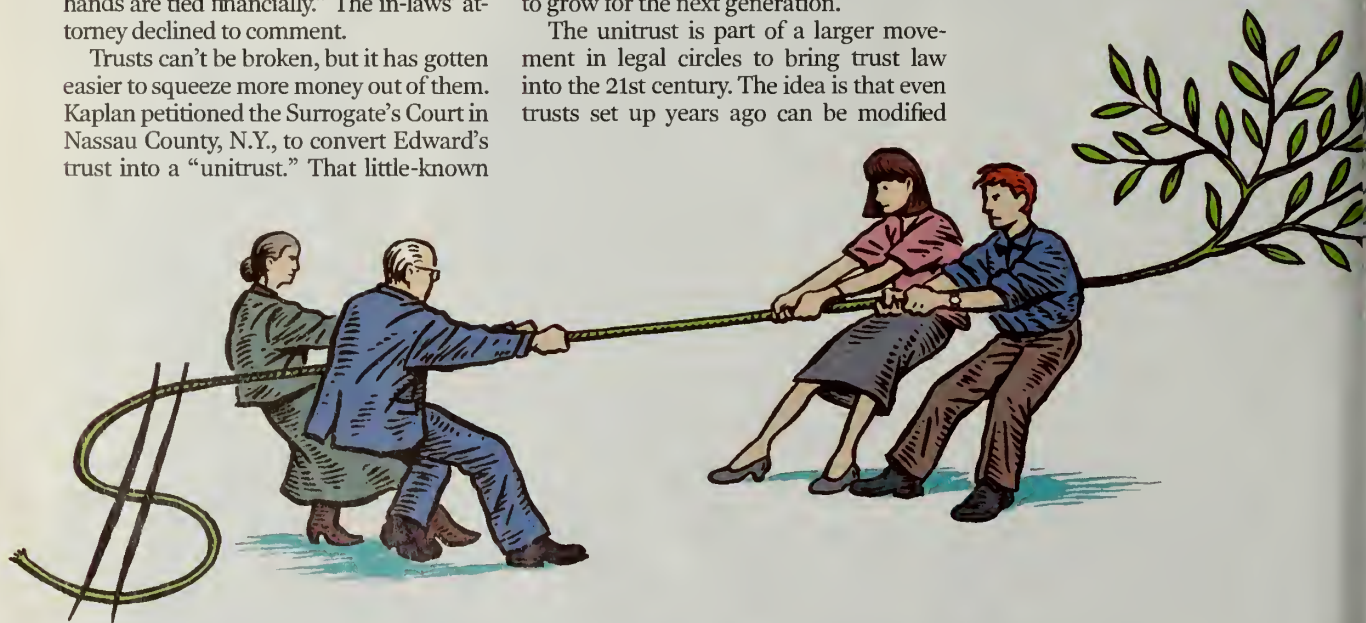
to solve current problems. For instance, the decades-old practice of splitting portfolios between bonds and dividend-paying stocks doesn't always generate enough income in today's low-dividend environment.

KNOW THE LAW

NOW, TO MEET their goals, trusts need to invest for total return and, if necessary, some of the cash payout by selling assets. In 39 states, trust beneficiaries can sue the trustees for what's called a power adjustment. That permits trustees to use a measure of investment discretion in generating a trust's payout. In many cases, trustees can take this action on their own.

All of these changes started a decade ago when a panel of law professors and trust experts put forth revisions to the 1963 Uniform Principal & Income Act (UPIA) that most states have quietly adopted without publicity. "Most states are silent on the question of telling beneficiaries about unitrusts or the power adjustment," says Seymour Goldberg, senior partner at Goldberg & Goldberg in Jericho, N.Y. Goldberg maintains a list of a few estate attorneys, accountants, or corporate trustees are up to speed on the latest UPIA laws.

In fact, you can now purchase Goldberg's "The Adviser's Guide to the Revised Trust Accounting Rules" from the American Institute of Certified Public Accountants at cpa2biz.com. "The problem is, no one knows about this stuff, and beneficiaries don't have any idea about their rights under the law," he says. If they did, more trusts might come closer to satisfying the goals of those who set them up. ■



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BY GENE G. MARCIAL

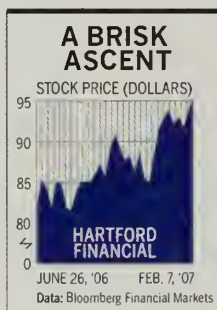
SALES OF RETIREMENT PLANS HAVE **HARTFORD GOING STRONG.**

CELL GENESYS IS READYING TWO VACCINES AGAINST CANCER.

CHINESE TECH GIANT **CDC LOOKS POISED FOR A SPIN-OFF OR TWO**

Hartford Is Leaping Up

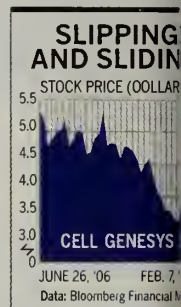
SHARES OF INSURERS are hardly on fire, but Hartford Financial Services (HIG) stock is lit. It streaked from 84 on Dec. 4, 2006, to 95.90 on Feb. 7—and is still climbing. “The stock has some distance to go, most likely to 150 in 12 months,” says Edgar Wachenheim, president of Greenhaven Associates, which owns shares. The multiline insurer easily beat the Street’s fourth-quarter profit forecasts and has been racking up annual gains in earnings of 10% since 1995. It has diversified away from the most cyclical and risky lines of property and casualty (P&C) insurance, says Wachenheim. It has increased, he notes, its retirement products, including mutual funds, annuities, and management of 401(k)s. In 2006, assets of its Hartford Life Insurance unit, which include retirement products, grew at 18%. As corporations shift away from defined-pension plans into defined-contribution, says Wachenheim, individuals look for safer ways to provide growing streams of retirement income, such as those Hartford offers. Nigel Dally of Morgan Stanley, which owns shares and has done banking for Hartford, rates the stock “overweight.” Hartford is one of “our best ideas for 2007,” he says. Some investors may worry about deteriorating prices in its P&C business, he says, but Hartford derives about half of its earnings from its life and annuity lines, and “results there suggest a strong growth story.” He foresees earnings of \$9.70 a share in 2007 and \$10.60 in 2008 vs. \$9.06 in 2006.



Will Healthy Lab Data Revive Ailing Cell Genesys?

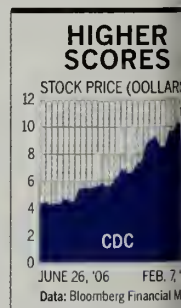
CELL GENESYS (CEGE) is in the midst of clinical trials of vaccines for prostate and pancreatic cancer that analysts believe should catch investors' eyes. But Cell's stock has been in a downspin since its high of 6.24 on Sept. 5. “There is a disconnect between the stock and Cell's fundamentals, which remain solid and on track toward two potential product filings,” says Pamela Bassett of Cantor Fitzgerald, who rates the stock, now at 3.07, a buy. Bassett, whose 12-month target for the stock is 12, says the “32-month survival data” on Phase II trials of its GVAX

pancreatic vaccine was “positive.” She also expects Cell to provide favorable interim data at the next American Society of Clinical Oncology Gastrointestinal Cancers Symposium in June. Data on Cell's GVAX prostate vaccine, in Phase III trials, will also be presented. Mark Monane of Needham, who also rates the stock a buy, says Cell is seeking to team up with big drugmakers on both. The prostate cancer vaccine has won a fast-track designation from the Food & Drug Administration, and Cell expects to provide three-year trial results in 2009. “We're encouraged by the Phase II data we've seen,” he says.



Why China's CDC May Climb Higher

ONE TOP PERFORMER on the NASDAQ is CDC (tick symbol CHINA), whose stock rocketed from 3.95 in June, 2006, to 10.58 on Feb. 7. There are more gains ahead, says David Riedel of Riedel Research Group, who is betting on a restructuring, which he says could kick up the shares by a further 50%. China's CDC is a global provider of enterprise software systems, mobile phone services, and online gaming, its fastest-growing unit. Riedel reckons the gaming—with 15% of estimated 2007 revenues of \$351 million and 18% of earnings of 39¢ a share—will be spun off to shareholders and taken public this year. No gambling is involved in CDC's online games, which allow players to compete free of charge. They pay, however, for virtual items such as costumes and weapons. CDC gaming has grown fast and now has 37 million players. Sasa Zorovic of Oppenheimer also rates CDC a buy and expects both software and gaming to be spun off in 2007. He forecasts profits of \$1.20 in 2007 and 61¢ in 2008 vs. an estimated 29¢ in 2006.



BusinessWeek .com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursday.
Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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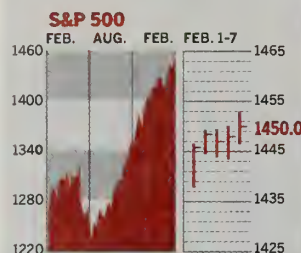


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STOCKS



COMMENTARY

Earnings season continues to chug along. Shares of Cisco Systems rose after the networking giant revealed a sunny forecast. That good news rubbed off on another techie, Intel, which was up 2.6%. Vornado Realty Trust surged 11% after pulling its bid for Equity Office Properties Trust. Disappointing fourth-quarter sales pushed MedImmune shares down 10.5%.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	FEB. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1450.0	0.8	2.2	15.6
Dow Jones Industrials	12,666.9	0.4	1.6	17.8
NASDAQ Composite	2490.5	1.1	3.1	10.9
S&P MidCap 400	850.6	2.1	5.7	11.1
S&P SmallCap 600	416.5	2.1	4.1	12.3
DJ Wilshire 5000	14,622.6	1.0	2.9	15.5

SECTORS

	FEB. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	819.0	0.8	2.6	9.6
BW Info Tech 100**	450.5	-0.5	0.7	18.7
S&P/Citigroup Growth	664.8	0.7	1.9	11.5
S&P/Citigroup Value	783.9	1.0	2.6	19.8
S&P Energy	448.1	0.2	-1.6	11.9
S&P Financials	506.5	1.6	2.3	20.0
S&P REIT	225.0	4.3	13.1	39.4
S&P Transportation	271.3	1.3	2.9	8.0
S&P Utilities	191.9	3.2	2.8	19.6
GSTI Internet	205.7	1.7	3.0	4.2
PSE Technology	904.3	1.4	3.3	4.8

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	FEB. 7	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2046.4	2.0	2.8	2.8
London (FT-SE 100)	6369.5	2.7	2.4	1.8
Paris (CAC 40)	5703.0	1.7	2.9	2.9
Frankfurt (DAX)	6915.6	1.9	4.8	4.8
Tokyo (NIKKEI 225)	17,292.3	-0.5	0.4	0.4
Hong Kong (Hang Seng)	20,679.7	2.9	3.6	3.6
Toronto (S&P/TSX Composite)	13,142.3	0.8	1.8	1.8
Mexico City (IPC)	28,123.8	2.0	6.3	6.3

FUNDAMENTALS

	FEB. 6	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.75%	1.77%	1.8%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	17.8	1.1
S&P 500 P/E Ratio (Next 12 mos.)*	15.4	15.1	1.1
First Call Earnings Surprise*	5.11%	4.36%	3.20%

TECHNICAL INDICATORS

	FEB. 6	WEEK AGO	YEAR AGO
S&P 500 200-day average	1333.6	1330.0	Posit
Stocks above 200-day average	80.0%	77.0%	Negat
Options: Put/call ratio	0.82	0.90	Posit
Insiders: Vickers NYSE Sell/buy ratio	5.82	5.89	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Retail REIT's	22.8	Tires & Rubber	69.1
Constr. Materials	21.3	Steel	63.6
IT Consulting	21.2	Department Stores	46.4
Industrial REIT's	19.9	Broadcasting	43.4
Steel	19.5	Motorcycles	39.0

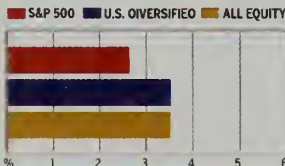
WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entnrmnt. Sftwre.	-5.6	Gold Mining	-5.6
Wireless Services	-4.4	Electric Mfg. Svcs.	-4.4
Food Wholesalers	-4.3	Education Services	-4.3
Instrumentation	-3.9	Homebuilding	-3.9
Compr. Stge. & Perphs.	-3.6	Oil & Gas Drilling	-3.6

MUTUAL FUNDS

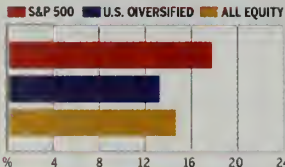
4-WEEK TOTAL RETURN

WEEK ENDED FEB. 6



52-WEEK TOTAL RETURN

WEEK ENDED FEB. 6



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4 WEEK TOTAL RETURN	%	52 WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	10.4	Real Estate	38.8
Real Estate	9.9	Latin America	33.9
Precious Metals	7.3	Pacific/Asia ex-Japan	33.4
Natural Resources	7.0	Europe	29.4
LAGGARDS		LAGGARDS	
Technology	1.0	Japan	-3.0
Japan	1.7	Technology	5.7
Domestic Hybrid	2.0	Natural Resources	6.8
International Hybrid	2.5	Health	6.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Lat. Am. Bull 2X Inv.	20.3	Dreyfus Prem. Grtr. China A	64.1
ProFunds Real Est. Inv.	17.0	ProFunds Real Est. Inv.	60.6
DireXn. Comdty. Bull 2X	16.1	Old Mut. Clay Finlay Ch. A	58.0
ProFunds UltraEmrg. Mkts.	15.7	Oberweis China Opport.	57.4
LAGGARDS		LAGGARDS	
ProFds. U.S. Emrg. Mkts. Inv.	-14.4	DireXn. Emrg. Mkts. Short	-40.9
DireXn. Emrg. Mkts. Short	-13.2	DireXn. Dev. Mkts. Bear 2X	-35.3
ProFds. Short Real Estate	-9.7	DireXn. Sm. Cap Bear 2.5X	-27.2
ProFds. U.S. Mid Cap Inv.	-9.6	ProFds. Short Real Estate	-25.6

INTEREST RATES

KEY RATES

	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.87%
90-Day Treasury Bills	5.15	5.11
2-Year Treasury Notes	4.87	4.92
10-Year Treasury Notes	4.74	4.81
30-Year Treasury Bonds	4.85	4.92
30-Year Fixed Mortgage†	6.17	6.30

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BONO	30 YR. B.
General Obligations	3.91%	4.2
Taxable Equivalent	5.59	6.0
Insured Revenue Bonds	4.00	4.5
Taxable Equivalent	5.71	6.4

THE WEEK AHEAD

INTERNATIONAL TRADE Tuesday, Feb. 13, 8:30 a.m. EST » The December trade deficit will have widened to \$59 billion; that's the consensus forecast among economists surveyed by Action Economics. The November deficit narrowed to \$58.2 billion.

RETAIL SALES Wednesday, Feb. 14, 8:30 a.m. EST » Retail sales most likely improved 0.4% in January, after a solid 0.9% rise in December. Excluding vehicles,

December sales very likely grew 0.5% following a solid 1% gain.

EXPORT-IMPORT PRICES

Thursday, Feb. 15, 8:30 a.m. EST » January import prices probably dropped 1.8%. Export prices likely rose 0.3%.

INDUSTRIAL PRODUCTION

Thursday, Feb. 15, 9:15 a.m. EST » Monthly factory output probably held steady in January, after a 0.4% rise. The utilization rate likely eased to 81.6%, from 81.8%.

PRODUCER PRICE INDEX Friday, Feb. 16, 8:30 a.m. EST » January producer prices are expected to have fallen 0.5%, after posting a 0.9% gain in December. Less food and energy, prices likely rose 0.1%, after a 0.2% December rise.

RESIDENTIAL CONSTRUCTION

Friday, Feb. 16, 8:30 a.m. EST » Housing starts probably edged up to an annualized rate of 1.65 million in January, from 1.64 million during December.

The BusinessWeek production index improved to 293.1 for the week ended Jan. 27, an 8.8% gain from year ago. Before calculation of the four-week moving average, the index rose to 293.2.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras.

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Executive Comeback Kit

FIRING BACK How Great Leaders Rebound After Career Disasters

By Jeffrey Sonnenfeld and Andrew Ward; Harvard Business School; 306pp; \$29.95

April may be cruel, but January was hardly kind, either, at least to a few high-profile executives. On Jan. 31, Dell announced that founder Michael S. Dell would regain the CEO title, pushing out Kevin Rollins. Just nine days earlier, Gap said its embattled CEO, Paul Pressler, would be leaving the retailer. And on

Jan. 3, Home Depot's board started the New Year off with a bang, bidding adieu to controversial Chief Executive Robert L. Nardelli.

Nardelli, of course, did walk out the door with a champagne-toast-worthy \$210 million. But if that's not enough to cushion the blow, he, along with the many other managers who've lost their jobs as the rate of executive turnover has spiralled upward, may find further consolation in a new book by Jeffrey Sonnenfeld and Andrew Ward called *Firing Back: How Great Leaders Rebound After Career Disasters*. A sophisticated self-help guide for the fallen chief executive, *Firing Back* is a smart, if at times overwrought, analysis of the leader's road to recovery. Using accounts of tragic failures and triumphant returns, the authors get inside the mind of the humbled executive and provide a framework for rebuilding a reputation that will be of interest to any manager.

Sonnenfeld, a senior associate dean at the Yale School of Management, and Ward, a management professor at the University of Georgia, organize much of the book around a five-step plan for recovery. To begin with, they advise shamed leaders to fight the urge to flee to a remote enclave. Instead, they should recruit acquaintances to speak out carefully on their behalf. The rest of the book is structured around four barriers to recovering from a career disaster: societal, organizational, psychological, and reputational.

One of the most compelling chapters looks at the potentially reputation-damaging causes of a CEO's departure and how these could have an impact on any chance for a rebound. Sonnenfeld and Ward surveyed 45 elite executive recruiters on how different types of forced exits influence a former CEO's career opportunities. Interestingly, these "gatekeepers" said firings for cause, such as poor performance or improper conduct, make it even harder to get seats on boards than to get a chief executive spot at another company. (No word on how such negatives might affect prized private equity postings.)

The authors' examination of organizational barriers that result from company or industry cultures is equally engaging. They begin with a typology of cultures ranging from "baseball teams" to "academies," "clubs," and "fortresses." This provides a fresh perspective on one of the business world's squishiest subjects. Then Sonnenfeld and Ward describe how in industries marked, for example, by "baseball team" cultures, such as software or entertainment, a failure is easier to overcome, because these fields experience constant change and movement of executives between companies.

The book is at its best when it offers personal reflection from leaders, whether famous or anonymous, who have fired and started over. "The day I was fired, I was in tears," says David Neeleman, the founder and CEO of JetBlue Airways, who in 1994 was ousted from Southwest Airlines, which had bought his first company, Morris Air. "I was angry and...determined that we would do something better than Southwest. With nine kids at home, my wife thought there was no need to get right back in."

Still, the volume would have benefited from even more such introspection. The authors often jump quickly from one famous name to the next, and the stories can feel repetitive. The authors also rely heavily on previously reported material. Examples such as Martha Stewart and Jeffrey Katzenberg feel overly familiar.

Some readers will cringe at the frequent use of the word "heroic" to describe CEOs' "mission" and "stature." Such grandiose terminology may flatter some chiefs, but it's a hard adjective to swallow in an era of scandal-tainted, lavishly compensated executives.

Still, even if the language is sometimes inflated, *Firing Back* makes a persuasive case

about the psychological damage firings can cause, and it will resonate with readers whose careers have suffered setbacks. Many leaders' identities are closely intertwined with organizations they've run. And because their firings often executed by a group of people (the board of directors), victims are less able to rationalize an ouster as due to the whim of an unfair manager. "Add to this the glare of publicity that surrounds the leader's public exit," the authors write "and the realities...become inescapable." Fortunately, as *Firing Back's* authors outline, there is a road to recovery.

—By Jena McGrath



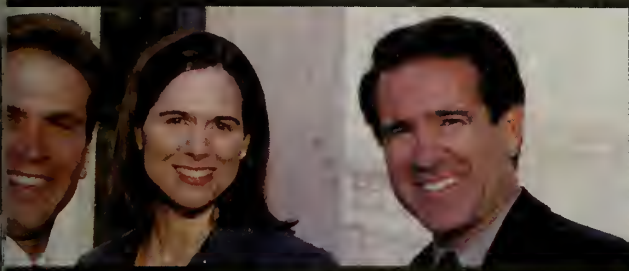
A savvy self-help guide for the fallen chief executive

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IdeasOutsideShot

BY MAX B. SAWICKY

Minimum Wage, Maximum Pork

The House of Representatives recently voted to increase the minimum wage, but the measure is being held hostage in the Senate by demands for tax relief for small businesses supposedly burdened by the wage increase. That may sound fair to some, but a closer review shows the tax provisions are clearly more inspired by politics than credible equity considerations

or sound economic reasoning.

Yes, a minimum wage hike will have effects. An increase to \$7.25 an hour could directly benefit nearly 6 million workers, lifting the incomes of many families currently under the poverty line or not far above it. But critics also claim the boost, estimated to cost employers about \$13 billion annually, would result in higher prices and fewer jobs. That's far from certain, and raises an important question: Who would be harmed, and, if they are, should they receive compensation?

Certainly, some companies will be forced to raise wages. But there is no precise way for government to predict which ones will be affected or by how much. Nonetheless, the Senate bill provides liberalized depreciation rules, kinder tax treatment of "S corporations" (which reap many benefits of incorporation without being liable for the corporate income tax), and an expansion of the Work Opportunity Tax Credit as compensation for paying low-wage workers more.

But the proposed breaks pertaining to depreciation and S corps could just as easily benefit owners not affected by the wage increase, those helped by it (say, high-paying restaurant owners whose lower-paying competitors would be forced to raise salaries), or even people who don't currently own a small business but invest in one in the future. In fact, the tax cuts could benefit a business with no minimum-wage employees—or one with no employees at all—because they're unrelated to labor costs, past, present or future.

The more generous treatment of depreciation allows a business to get larger deductions for the purchase of capital equipment or improvement of its facilities. That means, in effect, returns to new investment would be subject to lower taxes. But under the Senate bill, this new investment can be undertaken by anyone, and has nothing to do with whether the minimum wage hike affected the benefiting taxpayer.

Even worse, the tax breaks have nothing to do with whether minimum wage workers are retained or added.

New investments might well require more workers, but not necessarily low-wage ones. Or the tax break could make feasible an investment that reduced an affected employer's labor costs, allowing him to substitute capital for labor. In that case, it's the tax break, not a higher minimum wage that levies a terrible cost—on the worker.

The Senate bill provides new tax breaks for S corps on the grounds that, since they're small, they'll be hurt by a minimum wage hike. In reality, lower-wage workers are spread across businesses of all sizes. And while S corps are usually small, that doesn't mean their net income is low or their owners poor. S corps with receipts exceeding \$50 million, for example, have a net income per shareholder exceeding \$1 million in 2003.

At least the third provision of the Senate bill, the expansion of the Work Opportunity Tax Credit (WOTC), relates to the minimum wage. The WOTC provides subsidies to employers who hire welfare recipients, veterans receiving Food Stamp benefits, ex-felons, high-risk youth, and other disadvantaged persons. Most such workers earn the minimum wage. But unfortunately, participation rates in WOTC are low, and its impact on employment is questionable. Indeed, recent research concludes the current Earned Income Tax Credit is more effective in bolstering low-wage workers.

Given the flawed logic behind the Senate proposals, why is Congress even talking about them as compensation for a minimum wage increase? In a word: politics. Everybody in Washington

knows these tax cuts are just pork, no less than past earmarks for such boondoggles as Ohio's National Packard Museum or Alabama's statue of Vulcan, the Roman god of fire. But rising concern about poverty and income inequality lends support to increasing the minimum wage without considering extraneous tax policy issues. Indeed, these tax cuts would never stand alone, so they ought not stand at all. ■

Max B. Sawicky, an economist at the Economic Policy Institute, is on the board of Americans for Democratic Action. He blogs at <http://maxspeak.org/mt>.

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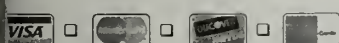
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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

That's Management!

Since there is such a bias in the markets for short-term results, how can you prepare for the long term?

—Wayne Abernathy, Washington, D.C.

In a word, that's management. Balancing the demand for quarterly results with the pressure for a profitable future is what good managers do for a living. Sorry if we sound exasperated, but every time we hear this question, we wonder: What do you think you were hired for? You were hired to wrestle a paradox—and pin it to the mat. And not just once, but over and over again.

Look, anyone can manage for the short term. Just keep squeezing the lemon, wringing out costs until there's nothing left but the pulp. And anyone can manage for the long term. Just keep telling people: "Be patient. Our strategy will pay off in time." The mark of a leader is someone who has the rigor, vision, and courage to do both simultaneously.

Take the example of managing people, a true short-long balancing act. Of course you want to motivate your team to deliver immediate results. You can do that with incentives and rewards, clear goals, and a passionate attitude about winning—the more passionate the better. But you can never stop thinking about developing your people, too. That means sending them to internal training programs or outside courses, giving them different experiences and stretch assignments, and encouraging them to take risks. Those activities may not deliver instant results, but they're an investment in the future that you must make.

It's the same story with managing R&D. Obviously, you need to fund projects that will improve and expand your existing products. That's usually money well spent, with relatively quick and certain returns. But some portion of your budget also needs to be earmarked for the kind of research that will deliver results in several years. Now, how much should go to each investment bucket? Your call, boss.

Perhaps the most common managerial balancing act has to do with marketing. With one phone call, you can take the easy way out and cut your advertising budget 20% to 50%. That will drop the savings right to the bottom line, with no sales impact for a quarter or two and no blood spilled in terms of programs or people. But what about the long-term

**Delivering
long- and
short-term
results at the
same time is
what it's all
about**

hit to market share and brand? That's the judgment call, and you're the judge.

Work requires dozens of decisions a day, but yours is the *über*-question of them all. As a manager, you'll spend your career answering it.

Companies let go of troublesome employees. Is it ever a good idea to apply the same practice to troublesome customers?

—Matt Silver, Wichita, Kan.

You mean, is the customer really always right?

The obvious answer is yes. You can't build a business without trying to satisfy every customer, even cranky, annoying, or unreasonable ones. Customers are like relatives. You can't pick them, so you better learn to love them.

But—and this is not an insubstantial but—there are some circumstances where that old adage about customer supremacy can actually be destructive, and it makes sense to say no or even good-bye.

The first is easy: It's when a customer's demand for price destroys your profitability, or worse, creates industry price chaos. That's when you have to hold the line and dump the customer even if it drives your salespeople crazy. The second circumstance is similarly unsustainable: It's when a customer demands a one-off product that sends your R&D group in the wrong direction, away from your own strategy and financial goals. Again, this is a case where your salespeople might be hollering for support but where the long-term diversion of resources is a killer. Unless it is an exceedingly profitable customer, you have to just say no.

The third circumstance is more nuanced. It's when a customer disrespects your people. Now, sometimes your big customers—the market-share monsters—can act a little obnoxious. They own you, and they know it. So with them you may need to endure some rudeness or outrageous demands as part of the cost of doing business.

It's different when the customer doing the berating is not your meal ticket but just a jerk. Then, your first line of defense is to switch the salesperson on the account, putting in someone with tougher skin and the mettle to say: "Hey, that has to stop." If that fails after a good try, it's time to walk.

Bottom line, we're not recommending that anyone ditch their "The Customer Is Always Right" plaque.

We'd just add a little asterisk. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.



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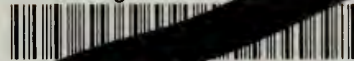


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Inside One Company's All-Out Attack
On Medical Costs BY MICHELLE CONLIN (P.58)

The Real
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at Citi (P.38)

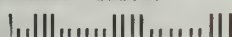
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CEO (P.80)

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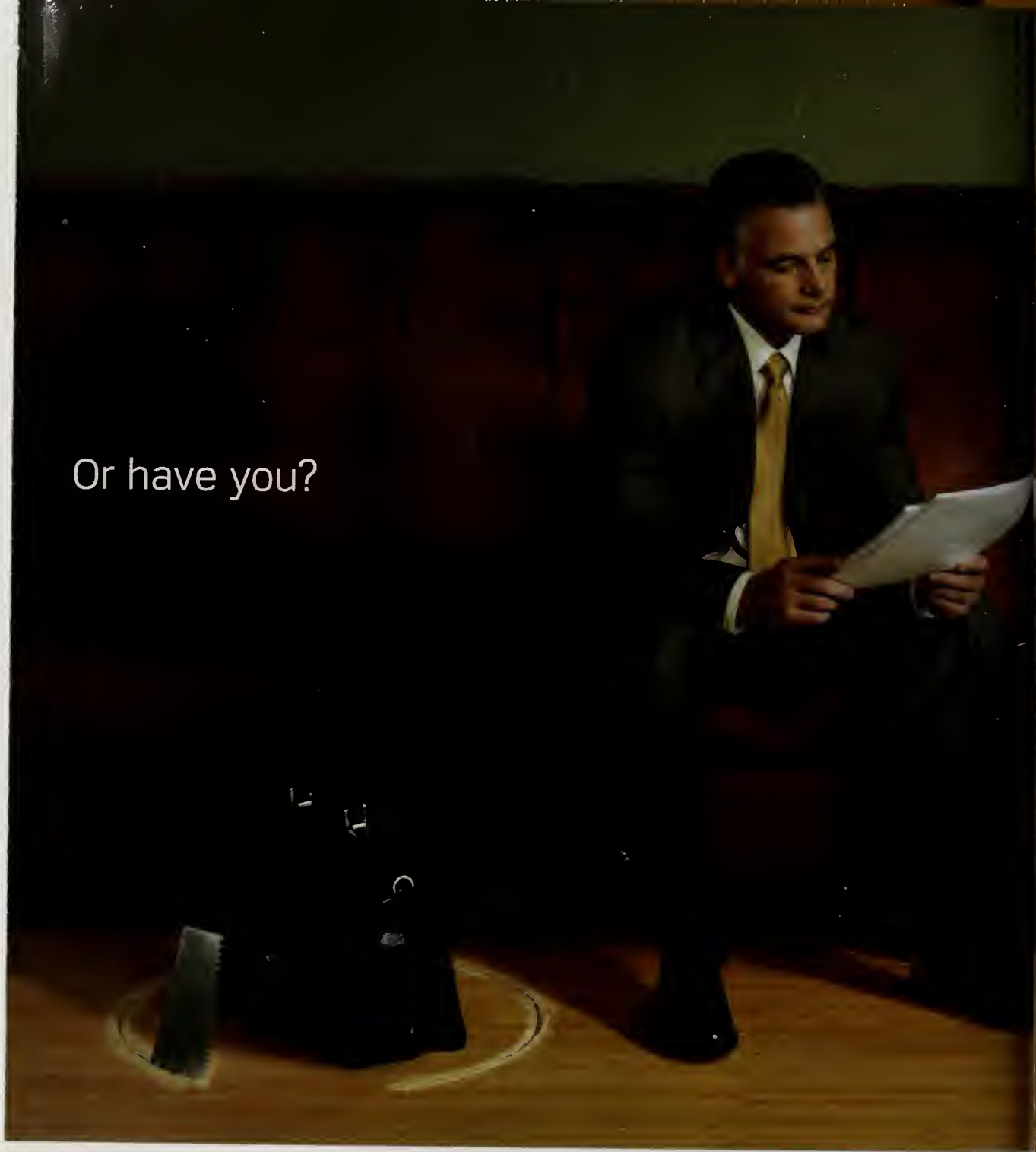


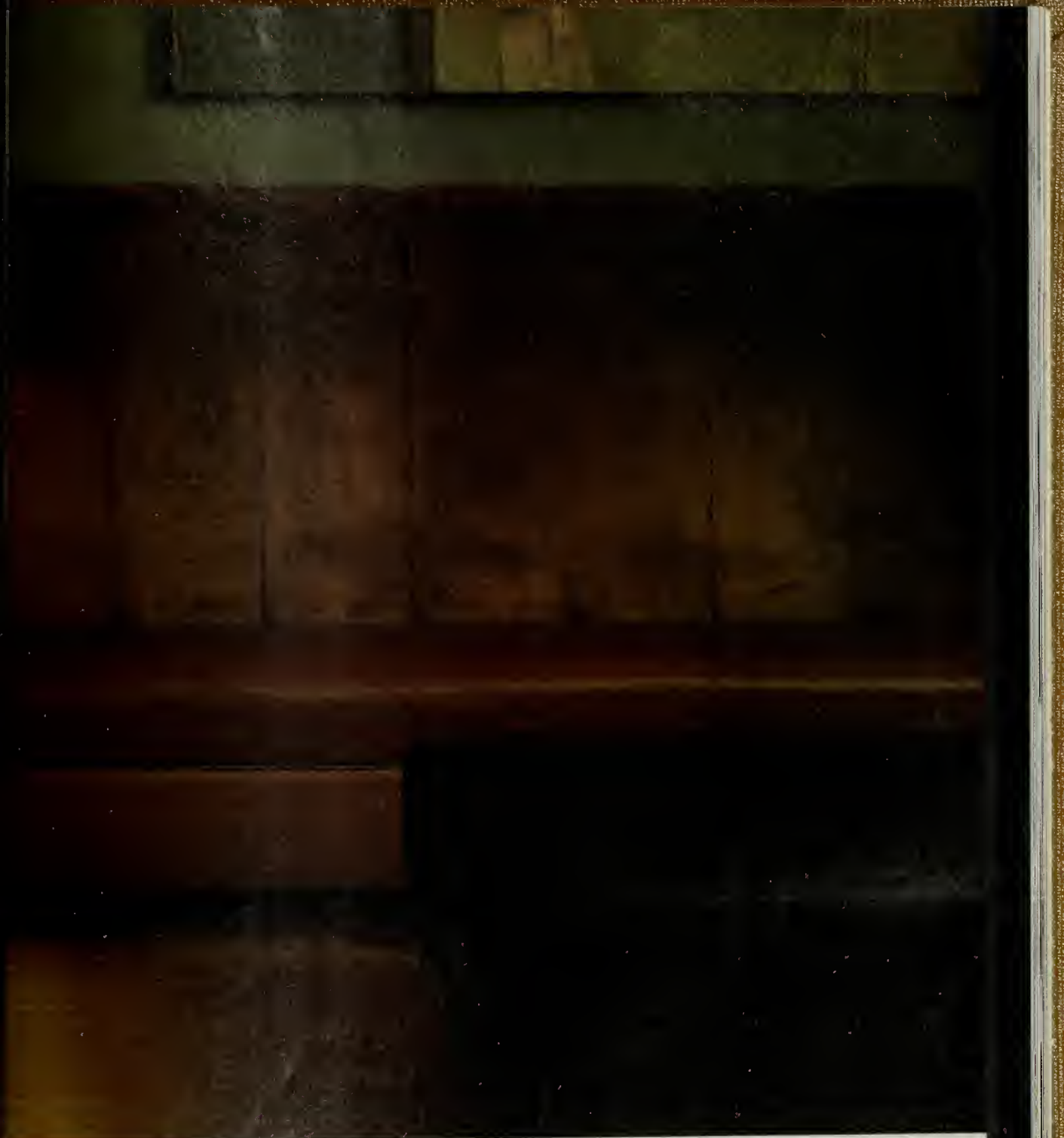
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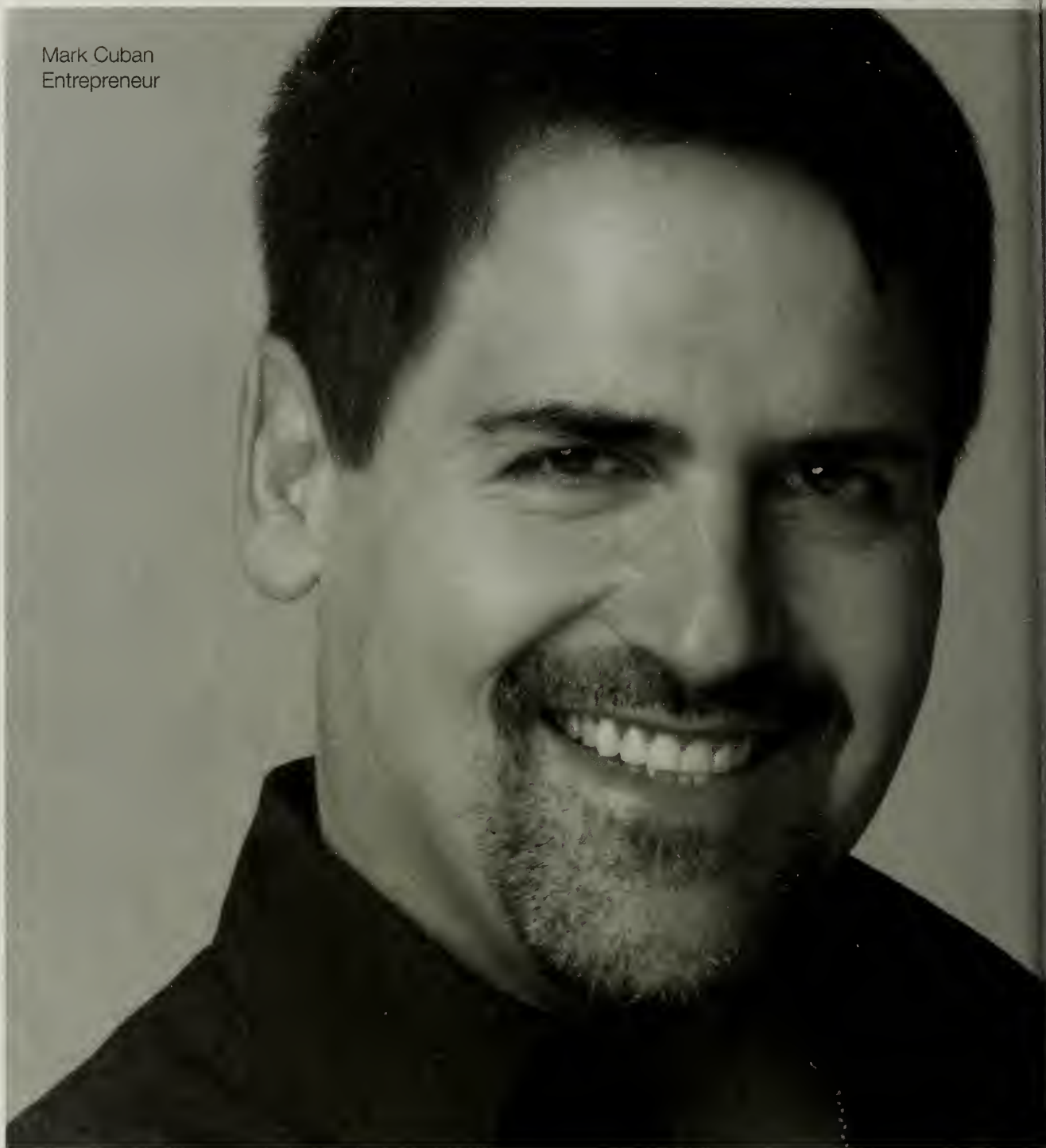




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Toyota U.S. Operations	
Plants	10
Total jobs	500,000
Investment	\$15B



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News You Need to Know

cuts at Chrysler; remodeling Home Depot; taking Google to task; and more

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are betting, riskily, on private equity

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se competition from smaller brands is a boon for consumers

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armaker's big bet is paying off

Wrapping the World in Tortillas

co's Gruma goes global

The La Dolce Vita MBA

rope, a focus on luxury retailing

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Joe Chlapaty's formula for success combines business, technology and higher education.



Joe is a trustee at beautiful Marietta College along the scenic Ohio River. Marietta is one of over 150 quality institutions of higher learning located in Ohio, ranging from top-ranked, comprehensive universities to challenging liberal arts colleges and specialized technical schools.

JOE CHLAPATY'S STORY

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Joe Chlapaty, President and CEO
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It's the quality of life that Joe and his family appreciate as well, particularly the outstanding educational experience his children received. Joe himself serves as a trustee for Marietta College and for the Ohio Foundation of Independent Colleges. In fact, ADS believes so strongly in Ohio's educational system that it has endowed a scholarship at Ohio University.

Ohio has been a great partner for Joe Chlapaty and ADS. It can be for you, too. **See how at OhioMeansBusiness.com or call 1-877-466-4551.**

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An Array of New Columnists And Insights

Just about every month, it seems, BusinessWeek.com welcomes a new columnist—an expert who brings another corner of the global business world into focus. The latest additions to our roster include Don Tapscott and Andrew Williams, co-authors of *Wikinomics: How Mass Collaboration Changes Everything*. In an eight-part series (www.businessweek.com/go/07/wikinomics), they build on the lessons in their book to show how leaders across industries drive changes in markets and even rewrite the rules of competition. Also new is Paul Bennett, creative director of design firm IDEO (www.businessweek.com/go/07/brands), who shares his unique view of brands. And for those seeking career advice, we have ethics expert Dr. Bruce Weinstein and

executive coach Marshall Goldsmith. Weinstein's Ask the Ethics Guy! explores the theory and practice of ethics. In Marshall and Friends, Goldsmith offers the same advice and insights he impart to his CEO clients. Look for them at www.businessweek.com/careers.

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Image courtesy of the human network.

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"We're going to be a channel for America—not for old white men with money."

—Neil Cavuto, Fox News senior vice-president and managing editor of business news, on Fox's new business channel, expected to launch in the fourth quarter, as reported by MarketWatch

ED BY DEBORAH STEAD



STAR SECTOR Fees and royalties from U.S. movies are up

E TRADE GAP

There's Good News, Too

YES, THE \$764 BILLION U.S. trade deficit racked up last year is a record-breaker. The bill for oil imports set a new record, as did America's deficit with China, according to the **Commerce Dept.** report released on Feb. 13. Still, behind the headline numbers was a little-noticed good news. The U.S. actually posted smaller deficits with most of its big trading partners, including Canada, Britain, Europe, South Korea, Central America, South Korea, and Hong Kong, than in 2005. American exports of corn, copper, and aircraft, among other things, increased. So did royalties and license fees for movies and other intellectual property. "It's stealth improvement," says Michael Englund, chief economist at **Action Economics**, a Boulder (Colo.) research firm. According to *BusinessWeek's* calculations, the trade deficit, excluding oil and China, has sunk dramatically since peaking at 2.6% of gross domestic product in first-quarter 2005. It was just 1.6% of GDP in the last quarter of 2006. What's behind the improvement?

A slight decline in the dollar from its 2002 highs helped a bit. What helped more: strong worldwide growth, which pushed demand for U.S. goods—everything from **Boeing** jets to **Paramount** films. Action Economics' Englund estimates that global growth was a robust 5.3% in 2006 and will be 4.9% in 2007. Such rapid growth used to trigger high inflation, which led to recessions. But countries have gotten better at controlling inflation so growth cycles aren't cut short.

To be sure, the overall U.S. trade deficit is still a whopper. And while oil's contribution to that imbalance will diminish if prices stay at \$60 a barrel or below this year, China is another story. The U.S. boosted exports to China by \$13 billion last year, to \$55 billion. But imports from China rose \$44 billion, to \$288 billion. Beijing's gradual revaluation of the yuan won't resolve the problem anytime soon, says Oded Shenkar, an **Ohio State University** economist. The China deficit is "the big boy," Shenkar says. The bright spot for the U.S.: That widening gap is now the exception, not the rule.

—Peter Coy

THE BUDGET NOT MUCH FUEL FOR ENERGY R&D

SAYING THE NATION is addicted to oil, President Bush has called for a sharp jump in the supply of renewable and alternative fuels. What about the R&D needed to get there? The White House's 2008 budget, released on Feb. 5, asks for just a 1% increase in real R&D spending in energy, transportation, and the environment. The total amount, \$7.5 billion, looks paltry compared with what was spent in the past. In real terms, it is almost 19% lower than in 1994 and about 40% less than its 1979 peak. Here's how the amount measures up historically as a share of GDP. —Michael Mandel

Federal R&D spending on energy, atomic energy, transportation, natural resources, and environment



Data: Office of Management & Budget; BW

HYPER LINKERS

IT'S NOT WHAT YOU KNOW...

LinkedIn—the online professional site that is partly a social network and partly a virtual business card exchange—allows its 9 million users to list their connections to other site members on their profile page. So which members are the most linked in? Ranked by employer, those who



work at salesforce.com and at Google (on average, 48 connections), says LinkedIn spokesperson Kay Luo. The site boasts 130,000 recruiters, but the most connected users by job title are founders and CEOs (76), followed by board members (74) and, a bit further down, MBA students (44), who outlink senior recruiters.

School ties also matter. Students and graduates of Stanford business school have an average of 60 connections, followed by those from MIT's Sloan School (58), and Harvard Business School (57). And LinkedIn says the top-growing industries among new users include arts and crafts, libraries, and fitness.

—Lauren Young and Paula Lehman

ENOUGH ALREADY TRIMMING THE FAT FROM TECHNOLOGY

ARE GADGETS and software becoming bloated with features? “The typical company innovates by making their products bulkier,” says **Forrester Research** analyst Bruce Temkin, who studies customer experience.

To find the balance between functionality and the wow factor, makers of high-tech products are turning to cognitive psychologists at firms like **Perceptive Sciences**. The Austin (Tex.) market researcher, which has helped **Eastman Kodak** streamline its photo kiosks and **Dell** improve its Web site's navigation, says its six cognitive psychologists' training in reasoning and perception enables them to understand the limits of memory and comprehension.



A recent project involved testing an envelope-free ATM deposit feature for **Diebold**. Perceptive's psychologists interviewed a group of potential users, along with some ATM repair technicians. They then observed the group's behavior at the new type of ATM, focusing on the ease or difficulty of making deposits this way and any signs of frustration. The results prompted Diebold to make its design more

intuitive, with modular parts that can be swapped for quick repairs. (The new ATM feature will roll out later this year.)

Perceptive's CEO, Jamie Rhodes, says the approach counteracts a tendency to equate more features with a better product. Forrester's Temkin echoes that thought. “[Companies] should do deep, primary research on what customers really need and want,” he says.

—Elizabeth Wojcik

REALITY CHECK

STRAIGHT FROM THE WEB: GO OUTSIDE AND PLAY

A SPOOF OF Second Life—the online universe in which members create avatars to cavort and consume—has arrived, courtesy of the comic

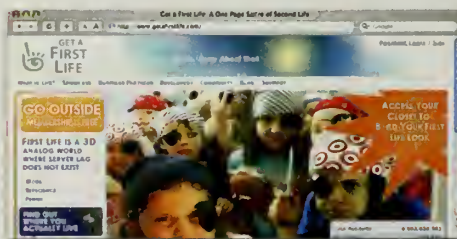
with their virtual worlds that they're missing the real one. Billing itself as a “3D analog world where server lag does not exist,” the site's home (and only) page promises answers to real life's vexing questions: (“What's this body thing...?” “Why can't I build a dirigible with my mind?”)

to “the dress-up nature of Second Life,” Barefoot says.

The target of this satire is exhibiting a sense of humor about the send-up. Shortly after Barefoot put up the site, a lawyer at **Linden Lab**, the owner of Second Life, posted a proceed-and-permit note on Barefoot's blog, a parody of the standard cease-and-desist letter.

Get a First Life has drawn 350,000 unique visitors since it went up on Jan. 20. Barefoot says he doesn't have Second Life, just the recent “corporate invasion and media hype” about it.

—Alli McConn



mind of Darren Barefoot. A Canadian blogger and marketer, Barefoot recently created www.getafirstlife.com to poke fun at those so busy

And it proudly displays its number of “total residents” (6.5 billion so far), with pictures of some of them: kids in pirate costumes, a reference

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PORSCHE

CAMPAIGNS

A CRY FOR HELP FROM CARMAKERS?

FOR THE SECOND time in two weeks, an automaker has chosen suicide to fuel the plot of a new ad, to the chagrin of suicide prevention groups and the bewilderment of



marketers. On Feb. 9, **General Motors** agreed to edit an ad first aired during the Super Bowl, following complaints by the American Foundation for Suicide Prevention about a dream sequence in which an assembly-line robot jumps off

a bridge after messing up at work. The AFSP said the scene treated the jump casually and was too vivid for families suffering the aftermath of a suicide. Three days later, **Volkswagen** of America debuted an ad in which a young man prepares to jump from a building, only to be deterred by news of three VW cars starting under \$17,000. "When did suicide become the thing to do in ads?" asks marketing consultant Dennis Keene. "And how does VW not rethink it after GM got nailed?"

Spokesman Steve Keyes says Volkswagen was aware of the GM issue but that "the point of the campaign is that optimism can prevail over despair." AFSP executive director Robert Gebbia argues that graphic suicide depictions can be dangerous to vulnerable people. About VW's plan to keep running its ad, he says: "Let's hope they change their mind." —David Kiley

BLOGSPOTTING DOSE OF CRITICISM

pharmamarketingblog.com

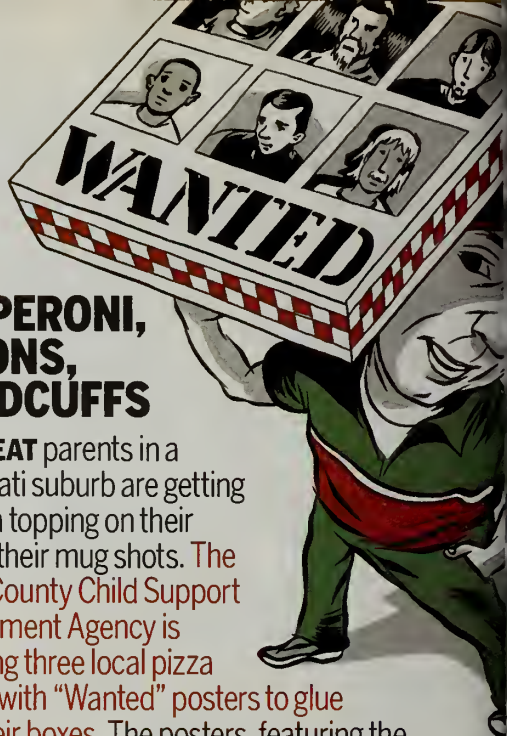
» **JOHN MACK**, publisher of e-newsletter *Pharma Marketing News*, uses this blog to sound off on drug industry ad campaigns. Recently up for discussion: The poorly received Super Bowl spot for Flomax, used to treat benign prostate disease. "If you are going to show an ad on one of the manliest sports events broadcast in the U.S.," Mack argues, be sure it's for something that doesn't require mentioning sexual side effects. Other topics touch on the controversy over whether Merck's new cervical cancer vaccine should be mandatory for young women and, on a lighter note, the attire favored by drug reps.

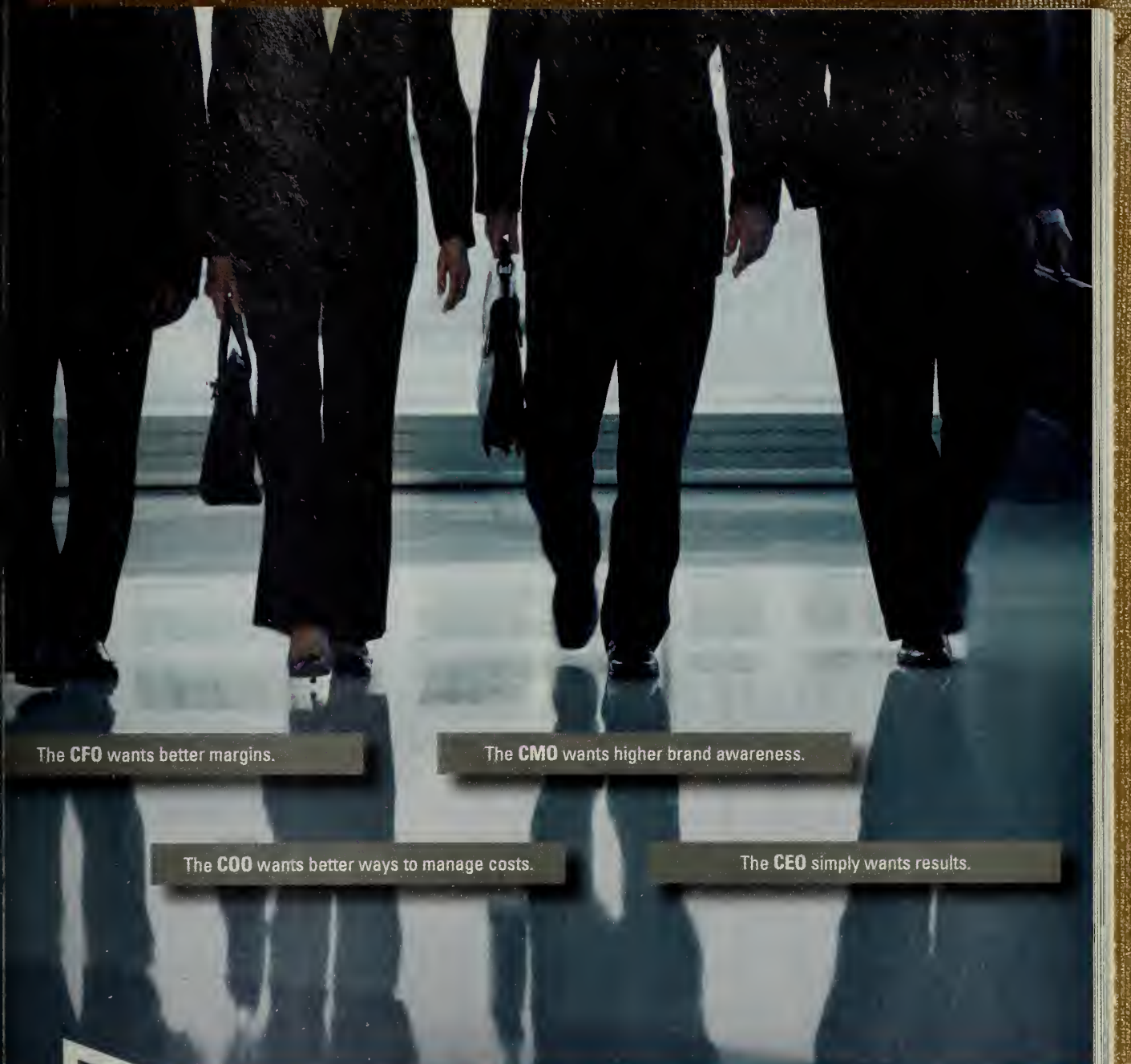
—Lindsey Gerdes

TIPS

PEPPERONI, ONIONS, HANDCUFFS

DEADBEAT parents in a Cincinnati suburb are getting an extra topping on their pizzas: their mug shots. The **Butler County Child Support Enforcement Agency** is providing three local pizza parlors with "Wanted" posters to glue onto their boxes. The posters, featuring the faces of non-support-paying parents for whom criminal warrants have been issued, have just produced an arrest, says the agency's chief, Cynthia Brown. Community support is strong, she adds, with similar agencies in two other Ohio counties contemplating similar programs. Brown says she gives tips to Karen Pizzeria, Angilo's Pizza, and Fairfield Pizza on what to do if one of the 10 featured offenders is a customer. (normal. Call 911 afterward.) "Almost everyone who's hiding," she figures, "orders pizza." —Lindsey Gerdes





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ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

In Cupid's Cubicle

What's your advice about starting an office romance? The idea of having a relationship with someone at work seems natural enough. But we hear so much about the pitfalls of acting on our attractions.

GETTING involved with a co-worker is partly a matter of opportunity: Given the long hours most people put in at work today, the office is a logical place to meet someone. But other elements figure in, too. Workplaces can be intense, intimate environments. The deep bonds that develop in the crucible of work, along with stress (and the need to find release from it), can eroticize relationships.

That's not necessarily a bad thing. Some office romances live happily ever after. Sexual tension can even fuel productivity, as people try hard to impress the objects of their desire.

Indeed, if a recent poll is any guide, relationships and romance are alive in the American office. Four out of every 10 employees who answered a Spherion/Harris Interactive survey taken in January say they'd consider an office romance. About the same percentage say they've already had one.

But many among the 1,500 employed adults in the survey—4 out of 10, again—worry that such relationships can jeopardize job

security and advancement. Why this fear? Two reasons, I think. The first is psychological. Romance with a colleague can feel forbidden or incestuous, creating an air of secrecy that elicits guilt. A focus on the pitfalls can be an expression of feared punishment.

At the same time, we all read about the ill-fated liaisons that regularly make headlines. So there are real dangers. Sexual harassment law rightly protects an employee from the unwanted advances of a superior, for example. Thus, if you're attracted to someone who reports to you, first borrow a page from Nancy Reagan's book: Just tell yourself no. Even if you think your advances are welcome, keep in mind that it's risky to make the first move.

SOME COMPANIES also have rules forbidding all workplace love affairs. My own position on this: Office romances will occur, so rather than puritanically trying to outlaw them, management should focus on intervening when relationships develop that unfairly alter the playing field.

So what should you do if you're drawn to someone at work? Try to be honest with yourself. Does the allure arise from the other

Don't think you can keep your office romance a secret: It doesn't work

person's power? Or your power over him or her? (And if you're feeling the attraction even though you're committed to someone else, are you just reacting against the constraint of that relationship?) It's hard to overrule your emotions, but try to anticipate the consequences—including whether both of you can remain at the company if you get

involved. I know many executives who are happily married to people they met at work, including some who ignored conventional wisdom. But remember that if there's a reporting relationship between the two of you, the less powerful person will be the one asked to change jobs or leave. And don't

think you can keep the romance a secret. If just one other person knows, eventually everyone else will, too.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send him questions at analyze@businessweek.com

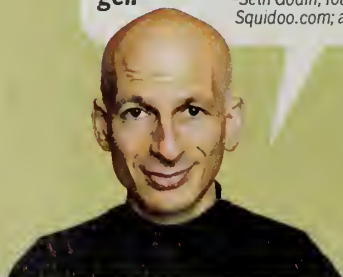


QUESTION OF THE WEEK

Ford is reviving the Taurus. Ray-Ban announced a relaunch of its original Wayfarer shades. What else would you like to see make a comeback?

"Bring back Braniff, People Express, and Pan Am. The planes were just as fast as they are today, the airports less crowded, and there were no superstitious bureaucrats obsessed with how much liquid I had in my shaving gel."

—Seth Godin, founder, Squidoo.com; author



"The Horn & Hardart automat, but contemporized: Put in \$10 and get Martha Stewart mac and cheese. And the Volkswagen bus. It has so much more charm than an SUV."

—Faith Popcorn, CEO, Faith Popcorn BrainReserve



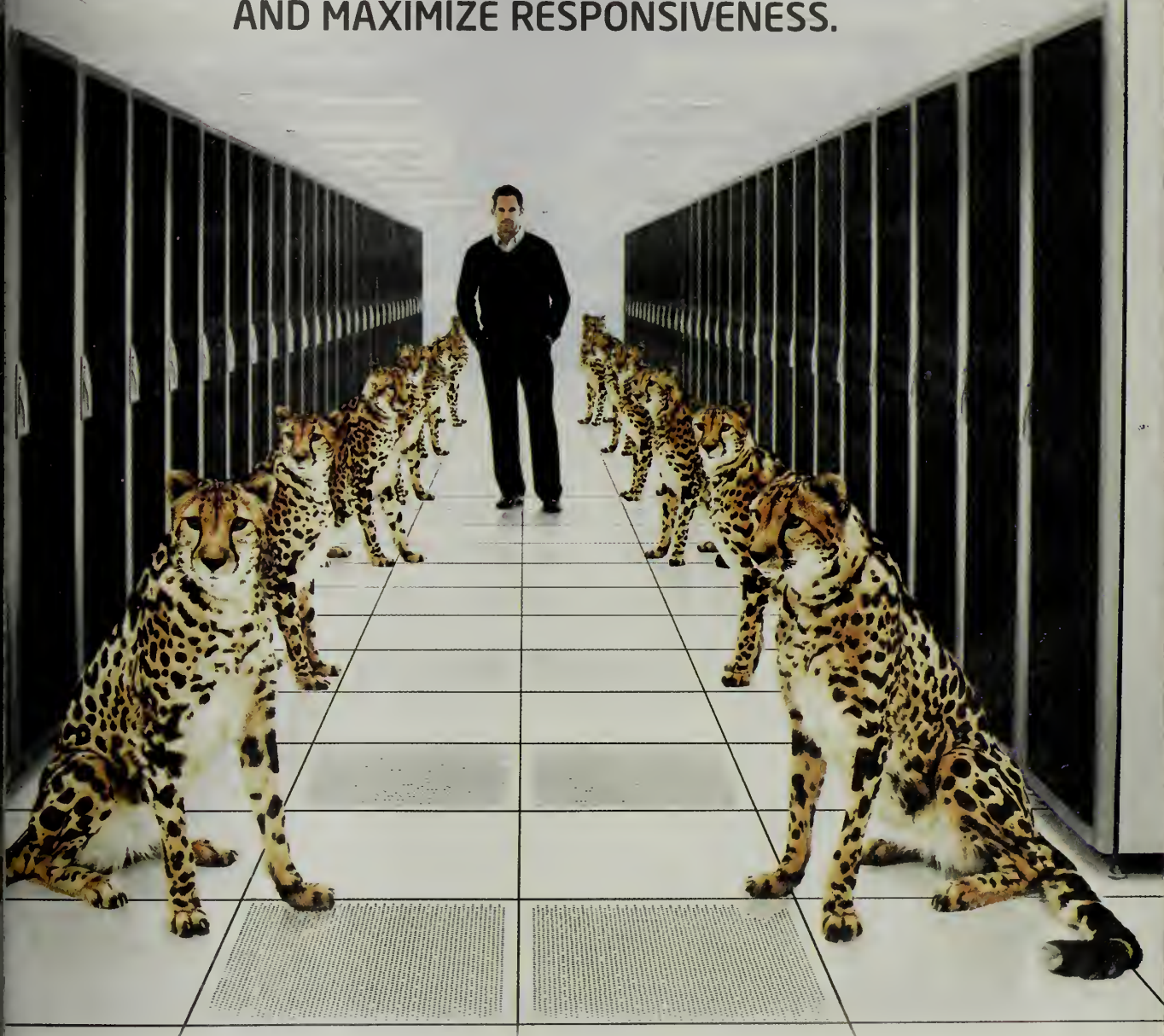
"The trait of embarrassment. CEOs caught backdating options aren't embarrassed; they spin their transgressions. And Alan Greenspan. We could never understand him, but we knew what he was going to do."

—Robert Brusca, chief economist, Fact and Opinion Economics





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A black and white photograph of a desert landscape. In the foreground, a single yucca plant with a tall, thin stalk topped with small flowers grows out of the sand. The sand dunes in the background are smooth and undulating. A dark blue rectangular box is overlaid on the left side of the image, containing white text.

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“In large cities a sizable percentage of [McDonald’s] workers...are Hispanic.... They are also a part of the fast-food giant’s success.”

—Wilther R. Santamaria
Centreville, Va.



WHAT ALSO MATTERS AT MICKEY D’S: THE FOLKS BEHIND THE COUNTER

AN IMPORTANT ASPECT of McDonald’s performance (“McDonald’s 24/7,” Cover Story, Feb. 5) is the human factor.

Employees are the backbone of every company or franchise—and McDonald’s has an increasingly multicultural workforce. In large cities a sizable percentage of its workers on the front lines are Hispanic. These workers face a language barrier and low pay, yet they overcome these obstacles by demonstrating discipline, a strong work ethic, flexibility, and the ability to learn the dynamics of food preparation and service.

They are also a part of the fast-food giant’s success.

—Wilther R. Santamaria
Centreville, Va.

DOCTORS AND BIG PHARMA: IT’S A TWO-WAY AFFAIR

I CAN RELATE to “The doctor won’t see you now” (News & Insights, Feb. 5). Three years ago, I was kept waiting in my urologist’s office while, in my presence, the doctor discussed menu choices at an exclusive San Francisco restaurant with a Big Pharma rep. The drugmaker

was hosting a thank-you dinner for doctors, and I was enthralled to learn that I would be bringing in a noted after-dinner speaker from the industry so that out-of-pocket expenses incurred by doctors during the evening could be written off as research expenditures.

Three years later, I was gratified to receive a substantial payment from settlement of a class action against the same company for overcharging car patients for the drug prescribed by doctor.

Doctors are not blameless in relationship.

—Jerry C. Davis
Santa Cruz, Calif.

YOU THINK THE hard sell to physicians is bad? How about direct advertising to patients, who often demand inappropriate therapy? Cutting that would go a long way toward slashing drug costs.

—Babak Roboubi,
Chevy Chase, Md.

WHAT ETHANOL CAN AND CAN’T DO TO SAVE THE PLANET

THE FIGURES QUOTED in “Food as fuel” (Environment, Feb. 5) require so

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scrutiny. It notes that producing 10 gallons of ethanol consumes the energy equivalent of 7 gallons of gasoline. What is not mentioned is that a gallon of gasoline contains 126,000 British Thermal Units of energy, while a gallon of ethanol contains just 85,000 BTUs. Therefore, 10 gallons of ethanol contains the energy equivalent of just 6.75 gallons of gasoline.

If the 10-to-7 ratio is correct, 10.38 gallons of gasoline will produce enough ethanol to deliver as much energy as contained in 10 gallons of gasoline. Even this ratio is probably optimistic, as it is difficult to fully account for how fossil fuels are used for farm machinery, transport, and ethanol processing, let alone production of fertilizer, pesticides, and herbicides.

The article states that by 2030, 49 million acres of farmland could produce 139 billion gallons of ethanol. This would equal 2,836 gallons per acre, which is two to three times the current ratio for even the most efficiently converted crops, such as switchgrass and miscanthus.

Finally, the idea of cutting down pine trees, or any tree, to make ethanol is as sensible as burning down forests in Malaysia to plant oil palm for biodiesel.

Has anyone considered just building wood-burning power plants? This would probably extract more energy from the wood, and emissions-control technology is probably more cost-effective than converting the wood to ethanol.

—Brian Gavin
Sammamish, Wash.

THE ETHANOL BANDWAGON rolls on despite solid evidence that the production and distribution of ethanol actually consumes more fossil-fuel energy than it returns when used in vehicles. The unattributed energy-balance relationship cited in your article is wildly optimistic. The agriculture lobby has been made absolutely giddy by the agricultural equivalent of cold fusion. We should temper our enthusiasm for biofuels through careful analysis of the applicable science.

—Ron Smith
Bend, Ore.

INCREASING THE COST of food in order to “grow” fuel is a scary proposition. Too many families are already hard-pressed to pay for their daily bread.

The justification that increasing food prices would be beneficial in terms of re-

ducing food consumption, and therefore obesity, is scandalous. Some people do anything to make a buck.

—Tom Sl
Hollywood,

I WAS SURPRISED that your story made no mention of how large amounts of government subsidies have created artificial demand for ethanol in gasoline. It would have been a real story if the conflict ethanol demands were being driven by a free market, but instead they're being artificially stoked by taxpayer-subsidized subsidies.

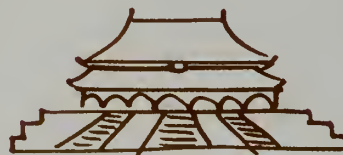
—Jim Van Als
Fairfield, Co

YOUR ARTICLE highlights what environmentalists dare not say aloud: There is, any solution to problems surrounding energy use (or all human consumption issues, for that matter) and environment that does not involve a substantial reduction in global population is doomed. No matter which way you turn, such as replacing fossil fuels with biofuels, one problem is alleviated and another is created because the fundamental calculus of human demand

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inexorable growth of our numbers in unchanged.

My opinion it is far too late to avoid agonizingly painful measures that be taken to avoid a "soylent green" e. Maximum sustainable population for this planet was reached about century ago. Yet population growth ins unabated and affects the poorest and least efficient societies the most. Horrific images of starvation and brought to us daily from places Darfur are going to become far more non than any of us imagines. The marish logic of Thomas Malthus, postponed thanks to technology, not been abrogated.

Our article merely points out why billions will suffer and die because we cannot control our minds to control our instincts.

—Geoffrey K. Wascher
Aurora, Ill.

AL CHINA GETS BETTER SERVICE THAN CALIFORNIA?

WE IN THE foothills of the Sierra da Mountains at approximately 10,000 feet. If the woman at 10,000 feet China Mobile's hot signal" (Global Business, Feb. 5) gets reliable cellular

service from China Mobile, why can't I get the same from Cingular (now AT&T's wireless unit), Verizon, or Sprint Nextel? All of those companies charge at least four times as much as China Mobile, and they have competition.

—Robin Robar
Paradise, Calif.

WHY GOLDMAN DOESN'T BELONG IN THE AD BUSINESS

WHILE THE GOLDMAN SACHS plan to combine separate advertising agencies, research firms, and festival producers may indeed create "fiestas," it also risks fiascos ("It's fiesta time at Goldman," Up Front, Feb. 5).

The challenge in creating a successful agency is to be totally client-centric. Great results are the direct benefit of an integrated, experienced team practiced in delivering a unique competitive edge. Goldman's piecemeal approach brings together separate disciplines without a unified vision or focused leadership, which is critical to building iconic brands. Where does the client benefit?

Companies that venture haphazardly into the nuanced and diverse Hispanic market usually get poor results and don't

return to that audience for at least five years. Yet those taking an integrated, analytic, and holistic approach typically recapture their investment within six months.

Wall Street buys concepts, and for the inexperienced, this one sounds great. No, *gracias*.

—George L. San Jose
San Jose Group
Chicago

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Gannett's New Lease on News

One of the never-ending delights of the human condition is the flukiness of inspiration, how creativity sometimes springs from unlikely places. And so it is that the newspaper chain with the most interesting and coherent approach to rethinking journalism and news-gathering is not the New York Times Co. or the Washington Post Co. It's Gannett, publisher of

USA Today and 89 other mostly midsize American dailies, a company, to put it gently, much better known for profits than Pulitzers. In this case, that probably helps. Rethinking a companywide approach is easier when there's a smaller institutional ego at play. By May 1 Gannett will have rolled out to all its papers initiatives enabling readers to interact with each other and assist its journalists. (These approaches also will be launched at Gannett's TV stations.) To describe these efforts, Michael Maness, vice-president of strategic planning and one of the strategy's architects, is eschewing such clumsy industry terms as "user-generated content," opting instead for the more euphonious "pro-am" (as in, professional-amateur) to underscore the blend of reader contributions and traditional reporting. If this succeeds—and early indicators are good—an unlikely company will lead the industry down an unfamiliar but promising path. "What I like about it is that it's not just about saving money, it's about saving journalism," says a reliably revved-up Jeff Jarvis, proprietor of media blog buzzmachine.com.

SOME OF WHAT Gannett stresses is the kind of Web 101 that local newspapers should have been doing all along. It will ramp up news-breaking efforts on the Web and rethink the product to deliver whatever to whomever on whichever platforms they desire—a phrase so hideously clichéd that most media observers can recite it robotically. Where things get really interesting, and where Gannett leapfrogs others' efforts, is in its pro-am blend. "The pros do the heavy lifting and build the framework and structure," says Maness. "And the audience can come in and fill in" around it. Perhaps the best early example of this fused approach took place at the *Fort Myers News-Press*. Home buyers were getting whacked with massive bills—as much as \$30,000—for simple water- and sewer-line connections. *The News-Press* kicked off its probe with a short item, in the paper and on its Web site, announcing it was looking into these fees, and, by the way, did anyone have anything to share? After that: the deluge. Certain documents surfaced, suggesting potentially illegal activity involving bids; local engineers scrutinized



"Pro-am" harnesses the power of citizen journalism

blueprints posted online. These were posted and feverishly discussed in forums, which in turn generated leads and drove follow-up coverage in print and on the Web. It's "a whole different way of building a story," says Executive Editor Kate Marymont. The "microsite" that hosted that chatter became *The News-Press*' most-trafficked, a position it maintains today.

All this speaks to a refocusing of ambition at the local paper that might not occur to grizzled news vets. When a bunch of blogs were launched at Gannett's lohud.com, which encompasses its dailies in New York City's Westchester suburbs, the blog on high school sports substantially outpaced the one about the Mets and the Yankees. It also speaks to the power of unfiltered data. (A favorite Maness saying: "Raw is good.") A big hit at Gannett's *Asbury Park Press* is its DataUniverse. There users can while away the hours dredging all manner of state and local databases: home sales, crim-

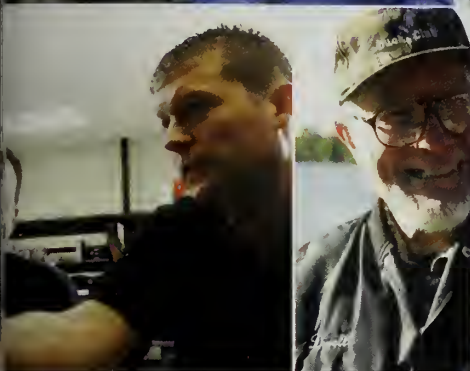
statistics, school district SAT scores, inmate records. If this sounds sleep-inducing, know that DataUniverse has notched over 4 million page views since its December launch.

What Gannett is doing isn't unique—many papers are toying with similar initiatives. What's new is the company's unified approach. And Wall Street analysts like what they see, which is no small feat for a newspaper company today. Merrill Lynch's Lauren Rich Fine (no relation) praises the company's moves and thinks they could generate "incremental" revenue and profit. If that's the case, Gannett will have cracked the toughest nut of all: how to keep making a buck from newspaper journalism. ■

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For Jon Fine's blog on media and advertising, go to www.businessweek.com/innovate/FineOnMedia

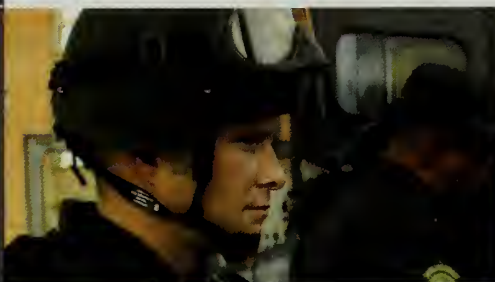


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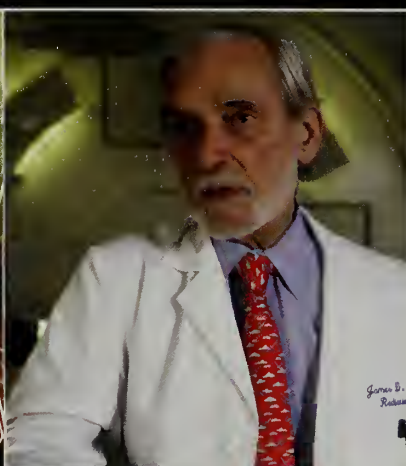
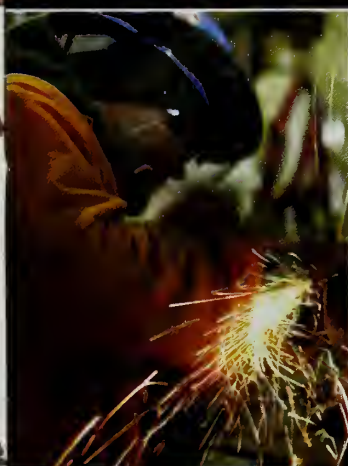
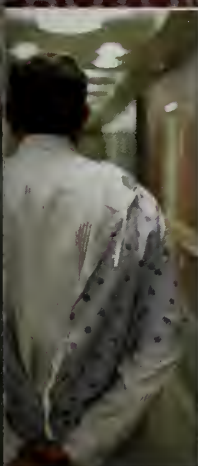
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Still Can't Beat a Post-It Note

Every “home of the future” I have ever visited—and I’ve been in a lot of them—features a family messaging center designed to replace paper calendars, notes, and other messy communication tools with a slick electronic device. The Hewlett-Packard TouchSmart IQ770 is the latest at creating this reality. But don’t throw away your Post-It notes just yet.

The \$1,795 TouchSmart is by far the most elegant all-in-one PC design I’ve seen from anyone other than Apple. It has the specs of a high-end PC and features a 19-in. widescreen, touch-sensitive display. Its height and viewing angle are easily adjustable. A wireless keyboard hides under the unit when not in use. The TouchSmart is equipped with tuners for both standard and digital TV broadcasts. The fact that it makes a nice high-definition TV takes some of the sting out of the price.

The kitchen is the communications hub of most homes, and this PC would spiff up any kitchen. If the software were as good as the hardware, I might find a way to squeeze a TouchSmart into my own.

I think the main reason families have communicated by sticking notes to the refrigerator is that the fridge is one place in the house everyone goes, and if you leave a note there, it’s unlikely to be overlooked. The TouchSmart replicates this phenomenon in software via something called the SmartCenter, a sort of customizable home page. Its three main features are a local weather forecast, a photo-editing program (whose prominence seems to reflect the importance of photo printing to HP’s business more than any consumer need), and the family calendar.

THE CALENDAR IS the information center—and the biggest disappointment of the TouchSmart. One way to interact with it is to leave a note, which is simple enough. You take a slip of virtual paper, compose the note by typing or writing on the screen with either the stylus or a fingertip, and choose a user or “everyone” as its destination. Although it uses sticky notes as a visual metaphor, SmartCenter misses the point. Notes stuck to the fridge work because they are in your face. Here you have to open the calendar program and tell it who you are before you see your messages.

Calendar entries, which are separate from notes, don’t integrate with the Microsoft Outlook calendar or any other



HP’s sleek PC makes a clunky home message center

image sharpness. HP uses an array of optical sensors around the screen edge. This leaves the screen cleaner; it seems more precise.

I still believe there’s room for a home information-and-entertainment center of this sort, but to reach a mass market the system has to be smaller, cheaper, and above all simpler. This application calls for a software platform other than Windows—a nimbler and quicker one with fewer capabilities and greater ease of use. In the end, the TouchSmart is just much of a good thing. ■

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JAMES C. COOPER

The Gray Area in the Fed's Blue-Sky Forecast

Further rate increases may be needed to tame a spirited economy

U.S. ECONOMY It has been said that monetary policy is a blunt instrument: Its overall impact on the economy is always difficult to gauge, especially since some sectors are more sensitive to interest-rate changes than others. That's why for more than a year the Federal Reserve has been tiptoeing around the housing sector, trying to beat

down inflation without hitting the real estate market so hard that the whole economy falls.

This year, though, housing will most likely begin to falter, even as the rest of the economy seems set to keep rolling along. This means the Fed will face a crucial decision: Will its current target interest rate of 5.25%, which worked so well to balance growth and inflation last year, be the right one to maintain that balance in the future? More to the point, it is not out of the question that the Fed will have to raise rates to assure that inflation recedes according to its plans.

If the central bank's new forecast in its Monetary Policy Report to the Congress, presented on Capitol Hill by Chairman Ben S. Bernanke on Feb. 14-15, is on target, then investors needn't fret. Policymakers expect growth to slow in 2007 and hold at about that pace in 2008.

They see labor markets loosening only a bit, with a slight uptick in the unemployment rate this year, and they look for inflation to edge down in both 2007 and 2008 (table).

The trouble is, Fed forecasts tend to show the results policymakers would like to achieve, and they exclude the policy changes necessary to reach their goals. Right now, the economy is behaving more like one that's ready to pick up rather than slow down. Overall demand outside housing grew faster in 2006 than it did in 2005, and consumers are off to a good start in January. As the drag from homebuilding fades, the underlying oomph in the rest of the economy will be felt more strongly.

THE REASON DEMAND REMAINS surprisingly robust might well be because monetary policy is a lot looser than you think. The Fed began lifting its policy rate from an unusually low level of 1% back in June, 2004, and by any measures, the current level of 5.25% represents financial conditions that are still accommodative to economic growth. Banks are more than willing to lend, and the credit markets see little risk in corporate borrowing. Long-term rates are low, and the dollar is relatively cheap in foreign exchange markets. Consider also that the Fed's real policy rate, or the rate adjusted for inflation, is still not very high compared to the peak levels reached in past episodes of Fed

tightening. With the Fed's preferred inflation measure running at about 2.2%, the current real policy rate is about 3%. That's above the long-run average of 2.4%, which economists think is close to a neutral policy that neither stimulates nor restrains economic growth.

IN THE FED'S TIGHTENING CYCLE in 1994-95, however, the real policy rate rose to just under 4%, a much more restrictive level, and in the 1999-2000 tightening it hit 5%. That level, if it had existed last year, would most likely have been overly constraining, given housing's vulnerability. But this year as the housing market stabilizes, the current real rate may not be restrictive enough to assure that the economy slows sufficiently to bring inflation back down into the Fed's comfort zone.

At the same time, the impact of the Fed's latest series

of interest-rate hikes is now wearing off. Fed policy actions operate with a lag generally thought to be about six to nine months. The last rate hike was in June, 2006, suggesting that by this spring whatever restrictive effects policy tightening is going to have will be fully incorporated into the economy.

Even now, borrowing conditions, always a key by-product of Fed policy, don't appear to be restrictive at all, especially with long-term rates still low. The yield on 10-year Treasury notes is currently about 4.8%, compared to a peak of more than 6.5% during the 1999-2000 Fed tightening and more than 8% in the 1994-95 episode.

According to the Fed's latest survey of senior loan officers at domestic and foreign banks, lenders sharply tightened their terms and conditions on mortgages to individuals in January, but standards on other consumer loans were generally about the same as a year ago. Banks said they eased terms on commercial and industrial loans

THE FED'S FORECAST OR ITS GOALS?

FED'S CENTRAL TENDENCY FORECAST 4Q TO 4Q PERCENT CHANGE			
	2006*	2007	2008
REAL GDP	3.4	2.5-3.0	2.75-3.0
CORE INFLATION**	2.3	2.0-2.25	1.75-2.0
UNEMPLOYMENT RATE (4Q AVG.)	4.5	4.5-4.75	4.5-4.75

*ACTUAL **PERSONAL CONSUMPTION EXPENDITURES
PRICE INDEX EXCLUDING FOOD AND ENERGY
Data: Federal Reserve

to businesses, while credit standards on these loans had barely changed. Plus, a net majority of banks narrowed the spreads between their lending rates and the rates they pay to obtain funds, indicating banks are still aggressively competing for qualified borrowers.

The same easy conditions are evident in the credit markets. For example, the rate on a 10-year, Standard & Poor's BBB-rated corporate bond, which is moderately risky but not speculative-grade, stood at 6.2% in mid-February. That's slightly lower than when the Fed began lifting its policy rate back in June, 2004.

In addition, the market's assessment of the riskiness of that bond is also lower now than in June, 2004. The spread between the BBB corporate yield and a riskless 10-year Treasury note has barely widened. Cheap money with low risk: That's probably not what the Fed had in mind as a result of hikes in its policy rate totaling 4.25 percentage points.

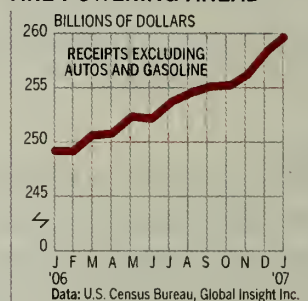
PERHAPS THE BIGGEST QUESTION MARK in the Fed's new forecast lies in the interplay between economic growth and the unemployment rate. Policymakers look for slower economic growth to open up only a slight bit of slack in the labor markets, a pattern they believe will be consistent with their goal for inflation to edge lower. However, if 2006 is a guide, it may not work out that way.

Last year, the economy slowed, but, contrary to the Fed's expectations, the jobless rate continued to fall. Job markets were tighter at the end of the year than at the beginning, increasing the threat that labor costs could sharply outstrip productivity gains and put upward

pressure on inflation. Unless growth this year comes in at the low end of the Fed's forecast range, job markets are likely to tighten even further, keeping the inflation threat from rising labor costs alive at a time when the Fed's price gauge is already higher than policymakers desire.

Tight labor markets and the job growth they reflect are key factors behind the economy's strength. They are the biggest reason why consumer spending remains so resilient. January retail sales were held back by weak auto sales and gas station receipts that reflected lower gas prices. Excluding those two sectors, buying activity in the remaining 70% of retail

WHERE RETAIL SALES ARE POWERING AHEAD



sales showed strong momentum heading into 2007. In fact, real consumer spending this quarter stands a good chance to grow at a rate of 4% or better for the second quarter in a row. As long as the pace of consumer buying continues to beat expectations, it's likely the growth of the overall economy will do the same.

The Fed has offered a picture-perfect forecast for 2007 and 2008. What's missing, though, is the level of interest rates needed to make it all happen. If the economy continues on its present course, that level may have to be higher than it is now. ■

GDP REVISION

Getting Our Losses Behind Us

WHEN THE SECOND look at fourth-quarter economic growth comes out on Feb. 28, expect a big downward revision to the 3.5% increase originally reported. It turns out that businesses clamped down on inventory growth more aggressively than anyone thought.

The monthly figures on business inventories showed no change, while the November gain was revised down slightly. The results not only fell short of what many economists forecasted but also were less than expected by the Bureau of Economic Analysis, the agency that tabulates gross domestic product.

In the initial gross domestic product

report, the BEA only has inventory data for the first two months. It estimates changes in inventory levels among nondurable manufacturers, as well as retailers and wholesalers for the final month of the quarter. In the initial fourth-quarter report, the BEA plugged in a 0.6% increase for December inventories, which led to the estimate that slower inventory

accumulation deducted 0.7% from overall growth.

Now it looks like the hit will be closer to 2%, says Mike Englund, chief economist at Action Economics. Along with weaker construction outlays and larger import results, there's a good chance that fourth-

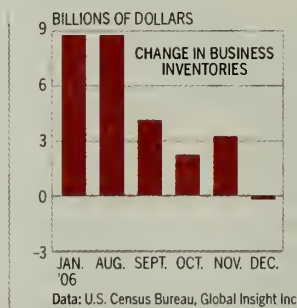
quarter growth could approach 2%.

However, the sharp inventory adjustment should translate into brighter prospects for economic growth going forward. While the correction is continuing into the first quarter of this year, especially in autos, it could be completed very soon. "As long as the sales trajectory remains solid, the inventory correction will be of finite length and now looks poised to end before March," says Englund. That view is bolstered by further sales gains among retailers in January.

Once businesses get inventories to more comfortable levels and the drag from the housing bust subsides economic activity should pick up even more steam. After a decent first quarter, Englund expects the economy will grow a solid 3% or more for the rest of the year. ■

—By James Mehring in New York

INVENTORY GROWTH COMES TO A HALT



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The Business Week

News you need to know

EDITED BY HARRY MAURER



Et Tu, Chrysler Valentine's Day wasn't exactly a love-in at **Chrysler Group**. The **DaimlerChrysler** unit followed **General Motors** and **Ford** in announcing drastic cuts: 13,000 workers over the next three years and 400,000 vehicles from its annual production (a Detroit plant, photo). Chrysler lost \$1.5 billion in 2006 after an operating profit of \$2 billion in 2005. **DaimlerChrysler Chairman Dieter Zetsche** said he's looking at all options for Chrysler, implying he might sell off all or parts of it. The most valuable piece is the **Jeep** business, but **Renault-Nissan**, as well as Chinese carmakers, might well be interested in buying chunks.

In other auto news, *The New York Times* reported on Feb. 14 that four of the nation's largest car-rental brands—**National**, **Alamo**, **Thrifty**, and **Dollar**, may team up. **Dollar Thrifty Automotive Group**, the paper said, is talking with **Vanguard Car Rental**, which owns **National** and **Alamo**, about a deal valued at more than \$3 billion. One likely outcome of such a merger: higher fees at the rental counter.

ONLINE See "Dr. Z's painful cure for Chrysler," www.businessweek.com

Remodeling Home Depot It's gut-and-reno time. Home Depot said on Feb. 12 that it plans to evaluate whether to sell, spin off, or take public **HD Supply**, its \$12 billion wholesale construction-supply unit. The announcement is the latest move by new **CEO Frank Blake** to overhaul the culture and strategy of the nation's second-largest retailer following the Jan. 2 ouster of **Robert Nardelli**. Critics have complained that margins at the wholesale unit are low.

The Feds Weigh In The **SEC** has joined the crusade against the plaintiffs' bar. On Feb. 9 the agency sided with the corporate defendant in *Tellabs Inc. v. Makor Issues Rights Ltd.*, asking the **Supreme Court** to make it harder for investors to sue companies for securities fraud. **SEC chief Christopher Cox** says the goal is to weed out frivolous suits. But while the SEC is bearing down on lawsuits, shareholders got a break in **Delaware Chancery Court**, which on Feb. 9 ruled for the first time that directors who O.K. stock option backdating or spring-loading can be sued for breach of fiduciary duty.

Fortress Looks Strong Investors stormed the barricades to get shares of **Fortress Investment Group**, the \$2 billion hedge fund and private equity firm, which went public on Feb. 9. It's the first U.S.-based hedge fund to do so. Shares rose 68% in their first day of trading, to close at \$31. The stock has fallen back a bit since then but still trades at a price a little under 40 times its past earnings—a lot multiple for financial-services firms. On paper, Fortress' founders are worth a total of more than \$9 billion. Look for other big hedge funds to follow suit.

ONLINE See "Investors storm Fortress IPO," www.businessweek.com

A Bourse Says 'No Thanks' Robert Greifeld, the marionette who heads **NASDAQ**, lost the race for the **London Stock Exchange**. His hostile offer of \$5.3 billion failed on Feb. 9 when too few shareholders tendered their holdings. Greifeld admitted to being "naturally disappointed."

See "NASDAQ Finance headline," page 5

Taking Google to Task For a company so dependent on the media, Google isn't making many friends in the business. Movie studios claim the search giant aided two pirate video sites, providing help on how best to run ads on Google and getting paid for them. Google said only that it bars ads that offer sales of materials that infringe on copyright owners, but it's working with the studios to stem piracy. Little more than a day after those complaints came to light, Google on Feb. 13 lost a copyright lawsuit to a group of Belgian newspapers. Google will appeal, but legal experts figure it will negotiate licensing or other deals to avoid what could be a precedent that hems in search engines.

ONLINE See "Belgian court deals Google a bombshell," www.businessweek.com

J&J Sleuths Itself On Feb. 12, **Johnson & Johnson** told the **Justice Dept.** and the **SEC** that some of its medical-device units had made improper payments related to sales in two foreign countries. The company's worldwide head of medical devices, **Michael Dormer**, retired as a result.

See "Big Pharma Under Fire," page 4

Vodafone Gets Its Prey There's not much growth left in its European backyard, so London-based Vodafone is hunting more aggressively abroad. On Feb. 11 it announced

ad bagged **Hutchison Whampoa's** 67% controlling stake India's No. 4 telecom operator, **Hutchison Essar**, for \$11.1 billion. Vodafone entered India in 2005 with a 10% stake in the largest local telco, **Bharti Airtel**. Vodafone now wields major clout: 23.3 million subscribers and a 16.4% share in the world's fastest-growing telecom market.

ONLINE See "India cheers Vodafone megadeal," www.businessweek.com

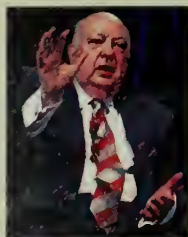
Vacancy for Outsiders **Four Seasons Hotels**, famous for its luxurious and pricey accommodations, is taking the vacancy to an even higher level. On Feb. 12 the luxury hotel chain's board accepted a deal valued at \$3.8 billion (including debt) to go private. The principals include companies owned by **Microsoft** founder **Bill Gates** and **Saudi Prince** **Alwaleed bin Talal**, as well as Four Seasons **Chairman and CEO** **Joseph "Izzy" Sharp**. The Toronto founder will get \$289 million in cash and a major stake in the private group, which now operates 74 hotels worldwide. He should be able to afford the penthouse suite for a while.

ONLINE See "Private equity slugfest," www.businessweek.com

Relief at Gradient It's always nice to hear you're in the clear with the feds. On Feb. 14, Scottsdale (Ariz.) research company **Gradient Analytics** announced that it had received a letter from the **SEC** saying regulators recommend that no action be taken against the firm. Internet retailer **Overstock.com** and drugmaker **Biovail** have filed lawsuits alleging that Gradient and a group of hedge funds attempted to drive down their stock prices. In a statement, Gradient **CEO Brad** **St** said the letter "confirms our resolve to...publish true and insightful information."

New Channel of the Week

Rupert Murdoch built his **News Corp.** empire by zigging while others zag—most notably in offering racier fare than his stodgier broadcast rivals. But will folks lap up corporate-business news on the **Fox Business Channel**, which launches later this year, as he confirmed on Feb. 8 at the **McGraw-Hill Media Summit**? So far Murdoch has signed up **Comcast**, **Time Warner**, and the News Corp.-controlled **DirecTV** satellite service to carry the channel. He promises it will be more sporty of business than **CNBC**, which, Murdoch complains, "leaps in every scandal." The new channel was the brainchild of **Fox News'** take-no-prisoners CEO, **Roger Ailes**, who told reporters that **CNBC** is "not as friendly to corporations and profits as they should be." Responds **CNBC** spokesman **Kevin Goldman**: "It doesn't surprise me that the alleged competition is starting with its usual lies and propaganda." Fox business anchor **Neil Cavuto** will headline the new operation. So forget about **Temptation Island**—anyone for **Temptation Options**?



ROGER AILES

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WALL STREET

THE REAL SCANDAL AT CITI

Is it using a high-level ouster and tabloid-style rumors to obscure the disarray and dismal returns of Chuck Prince's reign?

BY MARA DER HOVANESIAN

DID A FIREPLACE, A FISH-tank, and a friendship with a business journalist really end Todd S. Thomson's tenure as head of global wealth management at Citigroup? Or did other factors, just out of view, drive the ouster?

The question looms large as Citi struggles under the weight of poor financial performance and a disappointing stock price, and as CEO Charles O. Prince comes under increasing pressure to turn things around. Partly because of Citi's woes, many on Wall Street aren't taking the often-salacious press reports at face value. *BusinessWeek* has found that, indeed, some of the details don't stand up to scrutiny. And people familiar with the matter say that some Citi insiders bear

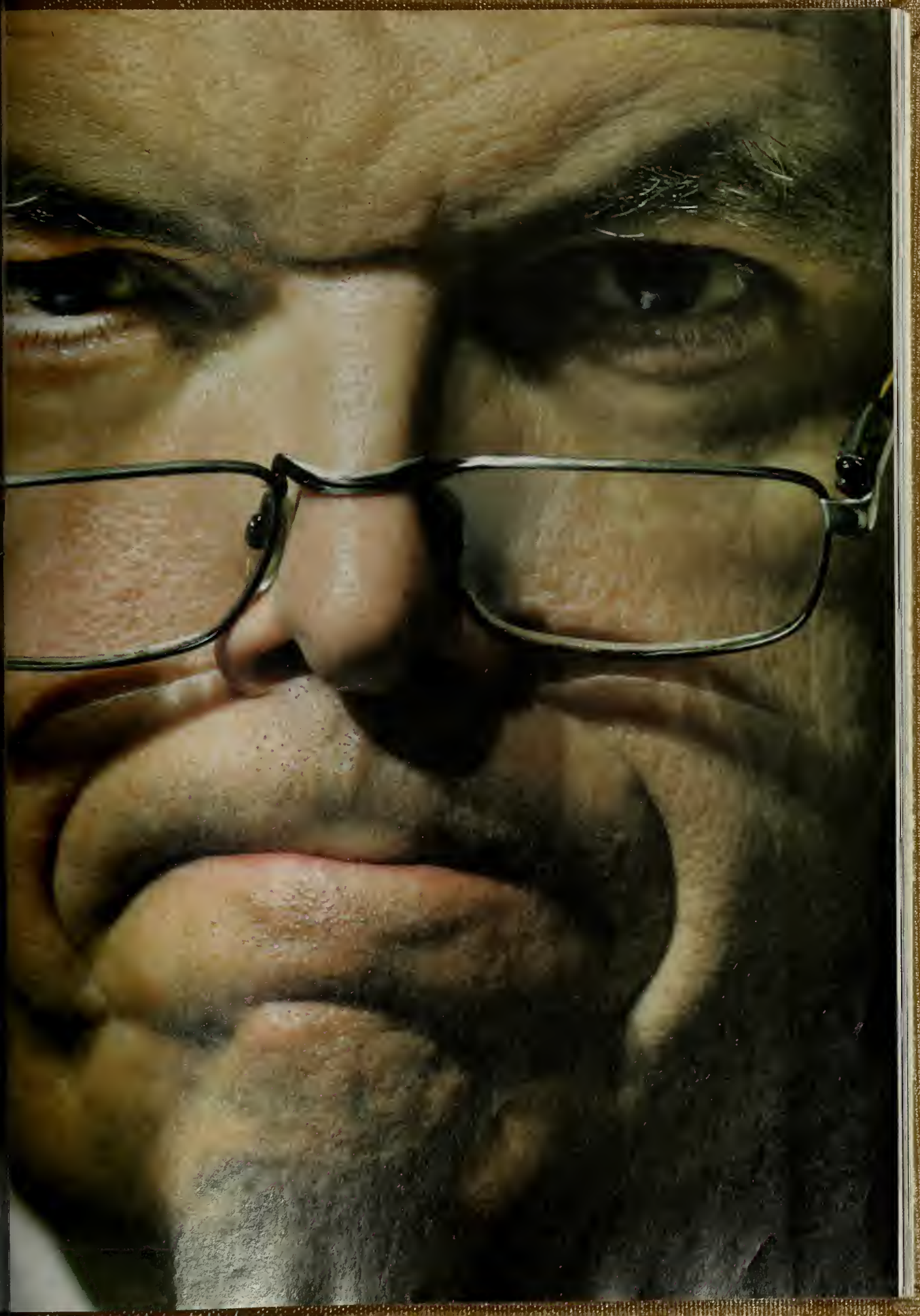
responsibility for spreading inaccuracies.

To recap: On Jan. 22, Citigroup announced that Thomson, 45, and a one-time rival of Chief Executive Prince, was out. Chief Financial Officer Sallie L. Krawcheck, 42, would step in once a replacement CFO was found.

Over the next several days, press reports citing unnamed sources offered details of Thomson's allegedly lavish spending. In particular, they described a luxurious office insiders called the "Todd Mahal," and as examples of his extravagance, they said he had installed a fish tank and a wood-burning fireplace. They also referred to a relationship between Thomson and CNBC anchor and *BusinessWeek* columnist Maria Bartiromo that seemed to go beyond the merely professional, citing a trip the two took from China to the U.S. aboard a company jet.

YURIKO NAKAO/REUTERS







Thomson, once one of Prince's rivals for the top job, says he has "no comment on the smear campaign"

But how much of it was true? Some of the descriptions of Thomson's spending were provided anonymously by people in the upper ranks of Citi's management. Yet other sources close to Thomson have confirmed that while Thomson's office had a fireplace, there were several other fireplaces within Citi—including one in the conference room next to the office of Robert Druskin, the bank's chief operating officer and cost-cutting czar. Moreover, Thomson's, like the others, was gas-burning (not wood-burning), and the connections for it were in place when Thomson moved in. The fish tank was nondescript and held goldfish—eight red and one black, a symbol of prosperity in Asian cultures and a cheap way to impress clients.

In general, say some Citi sources, the accusations seemed amped up. Other employees used Thomson's office to schmooze clients and even to host a recent book party for former Citi CEO Sanford I. Weill. "When you are in the high-net-worth business, you have to have people who relate to people worth \$1 billion," says Peter E. "Tony" Guernsey Jr., president of Wilmington Trust FSB, a New York bank.

Thomson, who is negotiating a severance package, hasn't spoken publicly about the matter. He told *BusinessWeek* that he has "no comment on the smear campaign I've been reading in the media" and is proud of his accomplish-

ments at Citi. "I think my record speaks for itself, and for now, I'm going to let it go at that." Citigroup declined to comment on the record, citing its press policy on personnel matters. Bartiromo has never spoken publicly about the issue. But sources say she has privately told friends and colleagues that everything she has done was completely proper and CNBC business.

The burning question on the Street is whether the alleged scandal was intentionally leaked to divert attention away from performance problems at Citi. The bank's fourth-quarter expenses shot up by 23%, while revenues increased just 15%. Full-year profits fell 12% from 2005. The operational successes during Prince's tenure—he took over for the legendary dealmaker Weill in October, 2003—have mostly been minor. All of which has been reflected in Citi's share price. The stock soared 78% between the time Citicorp merged with Weill's Travelers Group in 1998 and the time he left, but it has gained only 14% during Prince's term. During that same period, the Standard & Poor's bank stock index has risen 43%.

High-level sources within Citi categorically

deny the notion that someone in the bank was responsible for the story's sensational details. Other observers aren't so sure. Says William B. Smith, senior portfolio manager of New York money management firm SAM Advisors and a Citi investor, who has been calling for Prince's head since last summer, "Thomson was a beautiful scapegoat. I think Citigroup leaked everything...to take the spotlight away from what is really going on. It's another hour over there."

Other sources inside and outside the bank attribute Thomson's ouster to Prince's desire to consolidate power. Thomson, who served as chief financial officer under Weill, once had been considered a contender for the CEO slot before Prince was named. Says Richard B. Bo

an analyst at investment bank Punk, Ziegel & Co.: "He got rid of an irritant—and the last viable candidate for his job. I'm in the camp of believing that he is solidifying his position at the top and eliminating progressively each one of the people who might take over for him. There is no longer any obvious candidate to take his position." Hedge fund manager Tom Brown, a longtime critic, says the scandal is a sideshow. "The operative word is desperate. Prince is devoid of a long-term strategy and it will lead to his demise."

TENSION AT THE TOP

DESPITE THE RECENT allegations of profligacy, Thomson cultivated an image of fiscal restraint while he was CFO from 2000 to 2004. At a conference in 200

Thomson said Citigroup had "a real discipline around the place. That's something that I believe exists here perhaps like no other financial company. Roll up your sleeves, keep your costs in line, focus on it every day, every week, every month."

After being moved to the wealth management group, however, Thomson alienated senior executives. He was at times openly defia

RUNNING IN PLACE

Citigroup stock has trailed its peers



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of Prince and sparred with him on decisions about investments and strategy, according to people who worked with both of them closely and declined to be named. Thomson is considered by current and former insiders to be "extremely smart," but also "arrogant" and "full of himself." He was combative with Krawcheck, herself viewed as a possible Prince successor. And Thomson didn't have a good rapport with Smith Barney brokers, many of whom bolted the bank.

A source familiar with Citi says Thomson was warned to curtail his contact with Bartiromo months before the Asia trip last fall. The use of corporate resources in connection with that relationship was the sole reason Thomson was asked to leave, this source maintains. Prince was happy with the performance of the wealth management group, whose revenues were up 21% in the fourth quarter, one of the better-performing units within Citi. And the source says the cost to remodel Thomson's office was modest compared with what some other Citi executives have spent. Thomson's defiance of Prince's edict was the final breach, the executive maintains. Citi director Anne

In December, Prince cut his promised \$1 billion investment budget in half. He says credit worries are one reason to hang on to the purse strings a little tighter now. "A responsible manager spends the money when you have it and pulls in a little bit when you don't have it," he told *BusinessWeek* in January. "That's the right way to run the railroad."

But Prince's about-faces make it difficult for analysts and investors to know which way the trains are moving. "The problem is that the company has not kept its promises," says analyst Joseph Dickerson of Atlantic Equities in London.

THE CLOCK IS TICKING

PRINCE HAS MADE some progress. In the last year he has built 1,165 retail bank branches globally, one of the biggest expansions in the history of banking. That will allow Citi to draw more funds from deposits and rely less on the mar-



BARTIROMO
Did high-level Citi officials spread gossip about her?

quo is untenable."

Such negative sentiment is not universal. If it were, Prince would have gone by now. "I'm very nervous about talking about the end of Chuck Prince," says Howard K. Mason, senior analyst at Sanford C. Ber-

nstein & Co., a blue-chip research firm in New York. "I don't think the groundswell of resentment and disappointment is enough to shift the board."

Indeed, Prince appears to have the support of the board, at least for now. "There have been a lot more judgments placed on superficial impressions than on the facts," says Mulcahy. But he also acknowledges "a level of impatience" among investors. Former board member and current Traveler's CEO John Fishman says: "To the extent [Prince] can get the organic engine growing, the opportunities are enormous."

With doubts about Prince's stewardship swirling, his choice of a CFO is critical. Citi's third financial chief in three years will have to bring stability to the operation immediately. "Hiring a visible, high-quality CFO who actually has some power to reevaluate if all the pieces belong together" would help, says Marc D. Stern, chief investment officer at Bessemer Trust, which has \$46 billion under management. Says director Mulcahy: "It's a moment of truth for bringing in additional talent." The names in circulation include Alvaro G. de Molina, the former CFO and head of the investment bank at Bank of America Corp., and Goldman Sachs Group partner and Chief Financial Officer David A. Viniar. De Molina didn't return calls seeking comment. Viniar declined to comment.

Ultimately, Prince will be judged on his ability to create value for shareholders. Thus far he has been unsuccessful. Since January, 2004, Citi's shares have gained just 10%, much less than rival Bank of America's 32% and JPMorgan Chase Co.'s 37%. The comparisons with investment banking giants like Goldman and Morgan Stanley are less kind: Goldman is up 115%, Morgan Stanley, 40%. At some point soon the Thomson scandal will die down. The bank will appoint a new CFO. But the current ugliness won't be forgotten. ■

Universal Model, Uneven Results

These top financial companies compete on one another's turf. Here's how they stack up.

	Citigroup	Bank of America	JPMorgan Chase
STOCK PRICE APPRECIATION*	10%	32%	37%
MARKET CAP (IN BIL.)	\$262.8	\$237.5	\$174.8
PRICE-EARNINGS RATIO	11.8	10.8	12.4
REVENUE (2006, IN BIL.)	\$146.5	\$116.13	\$99.4
EMPLOYEES	299,000	203,425	174,360
U.S. RETAIL BRANCHES	972	5,700	3,050
COUNTRIES OF OPERATION	101	29	50

*Since January, 2004 Data: Bloomberg Financial Markets

Mulcahy, the CEO of Xerox, says: "Chuck made the appropriate call."

Whatever the cause of the firings—and the source of the leaks—the PR fiasco has hurt Prince's image among some shareholders, analysts, and employees.

In some ways, Prince, 57, has been his own worst enemy. He has promised since 2004 that revenue growth would exceed expense growth, but it hasn't happened. By contrast, from 1999 to 2004, the company boosted revenues by \$22 billion, while expenses increased by \$8 billion. Last year, earnings fell by 8.7%, well off the double-digit growth during the Weill era.

Prudential, lowering its cost of capital. He has reduced the number of data centers from 52 to 42, allowing for savings of up to \$2 billion by 2009. And by the end of the first quarter, COO Druskin will present a plan for a major overhaul to wring still more savings out of Citi's bureaucracy.

But the clock is ticking. Given the poor track record and growing disarray, some Wall Street veterans think Prince himself will be out by the end of the year if conditions don't improve significantly. Others give him until his five-year anniversary in October, 2008. "Something's got to give," says a Wall Street veteran. "The status

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CNET, 8/17/06

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COMPENSATION

A BETTER LOOK AT THE BOSS'S PAY

New SEC rules require greater disclosure, but don't expect CEOs to take a hit

BY JANE SASSEEN

NO TOPIC INFLAMES the passions of business leaders and shareholders like executive pay. Companies and compensation consultants argue that, in a free market, they'd be foolish not to pay the going rate for top talent. Investors demand that compensation be tied to performance and complain loudly when pay rises while share prices don't.

The perennial battle is about to reach a new level of contentiousness. The proxy season, just getting started, will be the first under new Securities & Exchange Commission reporting rules that force companies to disclose more about executive pay than ever before—from the hundreds of millions some executives stand to gain in severance, pensions, and deferred pay, to any perk worth more than \$10,000. Golden parachutes and sybaritic benefits such as club memberships and personal use of company jets won't score many points against a backdrop of the options-backdating scandal and increasingly empowered activist investors.

Thanks to recent blowups like that at Home Depot, shareholder-rights groups hold a distinct advantage in the public-relations war. Former Chief Executive Robert L. Nardelli walked away from Home Depot Inc. in early January with a \$210 million severance package, shocking shareholders unhappy with the company's flagging stock. And the timing couldn't have been worse for companies nervously preparing to reveal their own pay practices. "Home Depot is a preview of things to come," says Michael S. Melbinger, a compensation lawyer with Winston & Strawn in Chicago. "It's the perfect example of the rich payout that would have been buried before,

but which everyone now must disclose."

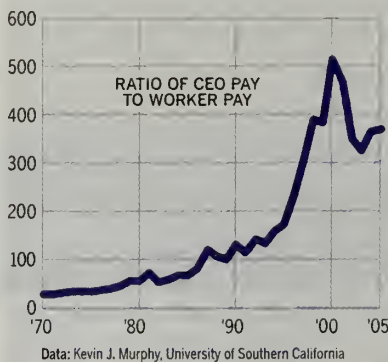
Governance advocates and politicians gain even more public support when they point out that in 2005 the average CEO in the Standard & Poor's 500-stock index took home 369 times the pay of the average worker, up from 28 times the average in 1970 (chart). The counterargument, that the ratio is down from the 514 multiple in 2000, doesn't get much traction.

THE LITTLE THINGS

SOME BOARDS HAVE BEEN looking hard at executive contracts and even tried to renegotiate them. Such minor perks as the personal driver and financial planning services are often on the table. But most boards plan to do little more.

In many cases, they can't. Almost all CEOs have contracts guaranteeing their big payouts. And the fear of angering a CEO over a pay issue has made directors reluctant to push harder. "No one wants to be responsible for seeing the CEO walk," says Jannice L. Koors, a managing director of pay consultants Pearl Meyer & Partners. In a survey of 110 companies at yearend, Mercer Human Resource Consulting found that 70% planned only

TOP DOGS



minimal changes to their executive compensation programs as a result of the new SEC rules; just 15% said the impact would be more substantial. Cutbacks in executives' packages are "just not terribly widespread," says Mark A. Borges, a former SEC official who is a principal at Mercer. Chicago lawyer Melbinger, who has sat in on recent board meetings, echoes Borges' view: "Yes, there's pressure to get rid of these deals, but I have not seen a single situation where an executive was willing to give one up."

To avoid provoking shareholders, companies are most commonly shifting pay out of categories that raise questions. Late last year aerospace giant Lockheed Martin Corp. said it would stop paying for a car and driver as well as club dues for CEO Robert J. Stevens. Instead, he hiked his \$1.48 million salary \$40,000, a spokesman says ending perks was in the company's best interests.

Some items, however, are too large



move or obscure. The biggest fights likely to be over multimillion-dollar deferred pay and retirement accounts, as well as guaranteed payments for executives who are fired or who leave when the company is acquired. Such items have been focal points of recent firestorms, from the Nardelli flap to the \$82 million pension Pfizer Inc. paid outgoing CEO Mark McKinnell last year. The surprise this proxy season, predicts Shekhar Purohit, a principal of pay consultants James F. Reda & Associates, is not just how common, and lucrative, these severance packages are. Typically they include a payment of three times salary and bonus, immediate vesting of options and restricted stock awards, and, in many cases, payment of taxes owed. Purohit says dozens of executives could see payouts of \$100 million or more. Revelations of extra-sweet deferred-compensation deals are sure to raise eyebrows, too. Such plans usually allow

executives to sock away money tax-free, often with a company match—much like 401(k) accounts, only with no limit on the contributions. And some companies guarantee better-than-market interest for executives. American Express Co. gave CEO Kenneth I. Chenault \$1.1 million in above-market returns on his deferred compensation account in 2005. The company won't divulge the rate it gave that year, but in 2006 it paid 13% on executives' deferred balances. In late January, AmEx said it would continue to pay 13% to 16% on money they set aside between 1994 and 2004 if the company meets or beats financial targets, and will pay 9% to 11% on money deferred after 2005. A spokesman says the plan is consistent with industry practice.

RICH RETIREES

PENSION PLANS WILL likely draw attention, too. Whereas regular workers typically retire on one-half to two-thirds of their average salary in their last three to five years, some CEOs get far more. Pfizer's deal with McKinnell was unusually rich: In calculating his final pay, Pfizer counted not only salary and bonus, but stock awards that vested through 2004. That notched his annual pension up from roughly \$3.5 million to \$6.6 million. The company says it stopped including new stock awards in pension calculations in 2001, but earlier grants were grandfathered in. Huge bonuses issued just before retirement can also pump up pensions. "It's the gift that keeps on giving," says Kevin J. Murphy, a professor at the University of Southern California's Marshall School of Business.

Governance activists are already targeting such practices. The United Brotherhood of Carpenters has identified 14 companies, including AT&T and Johnson & Johnson, where it believes the inclusion of large incentive bonuses in pension calculations has led to excessive benefits. So far, the union can claim one small victory. In January, American Express also announced further limits on retirement benefits. Rather than basing them on total salary and bonus—which for Chenault were \$1.1 million and \$6 million, respectively, in 2005—earnings used in calculating retirement will be capped at twice the annual salary. The AmEx spokesman says the changes, long in the works, stem

from the shift away from traditional defined benefit pensions to 401(k)-type defined contribution plans.

As for the smaller perks, companies maintain that some are born of legitimate need. For example, many argue that use of a company jet even for personal flights is a must in the post-9/11 era. Ditto home alarm systems and other security measures. The practice isn't universal. Intel Corp. and Goldman Sachs & Co. both forbid personal use of company jets.

Even so, in a study of 2005 proxies filed by the 100 largest U.S. companies, compensation research firm Equilar Inc. found that the median value of personal travel on corporate jets rose 21.7%, to \$109,000, while execs got roughly \$37,000 to safeguard themselves, up 69%. The numbers for individuals can fly much higher. United Technologies Corp. chief George David ran up a \$581,396 tab for "personal use of the corporate aircraft for security reasons," according to SEC filings. The company declined to comment. FedEx Corp. gave CEO Frederick W. Smith \$833,000 in jet use and security services on top of his \$1.3 million salary in fiscal 2006. FedEx, which requires the CEO to use the jet for all travel, says an independent security consultant determined the need for the benefits.

Still, jet travel irks some. Richard C. Breeden, a former SEC chairman who runs a hedge fund, criticized restaurant chain Applebee's International Inc. over the issue. He found that, over a 10-month period, Applebee's jet made 29 trips to Galveston, Tex., where Lloyd Hill, who stepped down as CEO in September but remains chairman, has a beach house. A spokeswoman for Applebee's, which said on Feb. 13 it will explore a sale, says its plane policy is disclosed.

One thing is clear: It is increasingly tough for boards to keep everyone happy. Retired General

Hugh Shelton, the former chairman of the U.S. Joint Chiefs of Staff who heads the compensation committee of software maker Red Hat Inc., says boards are focused more on finding the right balance between shareholder demands to link pay to performance and the company's need to ensure good executives have the right incentives. "You try to be fair, and give appropriate rewards for performance," he says. But ultimately, "you compensate them so that they're not desperate to go to work for someone else." ■

Severance and pension packages are sure to raise shareholder eyebrows



INVESTORS

HEDGE FUNDS JUMP INTO PRIVATE EQUITY

Eager to boost performance, they're entering the market at a risky moment

BY MATTHEW GOLDSTEIN

HEDGE FUND MAGNATE Steven A. Cohen is running with a new crowd on Wall Street. After hiring a seasoned private equity dealmaker in December, Cohen's \$12 billion SAC Capital Partners teamed up with buyout king Kohlberg Kravis Roberts & Co. on a \$3.1 billion deal for the higher learning outfit Laureate Education Inc. in late January.

Cohen isn't the only hedge fund guy expanding his repertoire. Hedge funds accounted for at least 50 private equity deals in 2006, according to Dealogic. Most recently, Farallon Capital Management joined with real estate investment trust Simon Property Group on a pending deal to buy mall operator Mills for \$1.56 billion. ValueAct Capital jumped into the \$3 billion deal in December for used-car auctioneer ADESA Inc.

The lures of private equity are twofold. First, hedge funds want to tap the gusher of money flowing into private equity from institutional investors. Second, and more worrisome, hedge funds as a group need a way to boost their performance. The

average fund returned 13.9% in 2006, according to the Credit Suisse/Tremont Hedge Fund Index—not much better than the 13.6% return of the Standard & Poor's 500-stock index. The typical buyout fund soared 25%, according to Mercer Investment Consulting Inc.

True to their nature, hedge funds are exploiting opportunities overlooked by their bigger private equity brethren. While brand-name firms are arranging mammoth buyouts—Blackstone Group's record \$39 billion acquisition of Equity Office Properties Trust, for instance—hedge funds are setting their sights on smaller prey. DE Shaw & Co., one of the more active hedge funds in the private-equity space, sank \$500 million into Kentucky's ERORA Group, a private developer of coal gasification plants. It's a typical size deal for the group.

In many ways, hedge funds' move into private equity is a natural progression, especially for the larger funds. Many are getting into the lending business, providing capital to startups and even financing more exotic ventures such as Hollywood movies. "[Private equity] is a perfect extension of what we do," ValueAct Capital founder Jeffrey Ubben says.

The lines between hedge funds and private equity funds will only get more blurred as more hedge fund types look to emulate \$30 billion Fortress Investment Group. Fortress, which saw its stock soar 68% in its first day of trading on Feb. 1, will deploy its capital any way it can to make money.

But the move into private equity is fraught with risk. Hedge funds are famous for their short-term investment horizons, usually a year or less. By contrast, buyout firms often take 3, 5, or even 10 years to extract themselves fully from private equity deals. The longer time line can make it more difficult for a hedge fund manager to price an investment.

INHERENT DANGERS

WHAT'S MORE, private equity deals are illiquid transactions, meaning a manager can't quickly turn them into cold cash. Too many investors seek to redeem their money, the fund could develop a cash crunch. That's one reason some hedge funds are putting limits on how quickly investors can reclaim their money. Most hedge funds require investors to keep their money locked up for a year. If funds moving into private equity are spreading that period to three years.

Another danger: timing. Some on Wall Street are fretting about a private equity bubble. In particular, they worry about debt that firms are heaping on companies they take private. Entering the market now could be highly dangerous, especially since these deals require real expertise. The question is whether hedge funds have the skills to pay the bills when the burning-hot buyout market cools.

Then again, hedge funds are supposed to be skilled at hedging risk. If private equity blows up, and the distressed deal market tanks as a result, it'll just be another buying opportunity. ■

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fig. A

THE ICONIC DESIGN FEATURES SIDE WINDOWS WITH NO B-PILLARS INTERRUPTING THE VIEW, YET HAS THE STRUCTURAL INTEGRITY OF A TRADITIONAL COUPE. AND IT'S JUST ONE OF THIS VEHICLE'S MANY ENGINEERING WONDERS.

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Then there are the available creature comforts—the Parktronic system, 14-way power-adjustable massaging seats, voice-activated audio, telecommunications and navigation systems, as well as the infrared Night View Assist system, to name but a few.

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BIG PHARMA

PUSHING THE PILLS A BIT TOO HARD

Feds and states are putting drug marketing under the microscope and seeing abuse

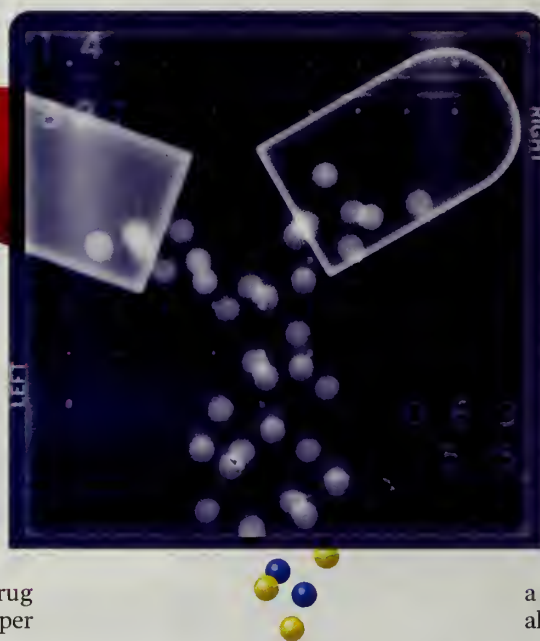
BY ARLENE WEINTRAUB

DRUG COMPANIES and medical-device makers keep tripping over laws designed to curtail their

hyper-aggressive business practices. The latest blunder: Johnson & Johnson disclosed on Feb. 12 that some of its units had made "improper payments in connection with the sale of medical devices" in two foreign countries. Neither J&J nor the Justice Dept. will comment on the details, but Michael J. Dormer, worldwide chairman of medical devices and diagnostics, took responsibility and retired.

In fact, federal and state investigators are looking into drug companies for everything from improper pricing to illegal marketing. Fines are raining down, and the crackdowns show no sign of letting up. Experts suspect the authorities are trying to send a message to the industry: Shape up or pay up. "No doubt there's a lot more attention being paid to these issues than there has been in the past," says Jerome P. Kassirer, a distinguished professor of medicine at Tufts University School of Medicine. "If enough companies get fined, maybe the industry will wake up and do something about it."

Much of the federal agency's vigilance is aimed at preventing companies from collecting more than they should from Medicare and Medicaid. Justice has 150 such investigations on its docket. The



department joined a whistle-blower suit against a U.S. manufacturing subsidiary of German drug giant Boehringer Ingelheim on Jan. 29. The suit alleges that their unit in Columbus, Ohio, artificially inflated prices for drugs it manufactures, in some cases by as much as 1,000 times, so it could reap higher reimbursement rates from federal health-care programs. "Our intervention in this lawsuit is another example of our ongoing effort to combat these practices and hold its perpetrators accountable for their misdeeds," said Peter D. Keisler, assistant attorney general for the Civil Div., in a statement released at the time. A

spokesman for the company responded that it "has at all times complied with the tangle of laws and rules imposed by the federal government and the five states."

OFF-LABEL OFFENSES

EVEN RELATIVELY small biotech firms are finding themselves on the radar of federal regulators. In October, Brisbane (Calif.)-based InterMune agreed to pay more than \$36 million to settle charges that it marketed one of its drugs for unnecessary or off-label uses. The government alleged that InterMune promoted the drug as a treatment for lung scarring, even though the U.S. Food & Drug Administration had only approved it to treat a rare immune disease and a bone disorder. "The company has a new management team, which has established an internal compliance program," a spokeswoman says.

State attorneys general are also up in arms. The Texas AG recently unsealed a case alleging one of J&J's drug subsidiaries, Janssen, improperly marketed one of its psychiatric products for use in children. On Feb. 9, the state's assistant attorney general testified before Congress that Janssen's aggressive marketing practices cost the Texas Medicaid program \$117 million over five years. J&J declines to comment. Meanwhile, Eli Lilly & Co. is facing civil and criminal investigations in several states over allegations that it concealed links between its Zyprexa, a schizophrenia drug, and diabetes, and also that it marketed Zyprexa for off-label uses. Lilly says the complaints are in an "early investigative stage," and that it intends to cooperate.

J&J may escape its foreign-marketing debacle with no charges and no fines because the company found the wrongdoing and reported it before the government dug it up. "That's the kind of conduct the government wants companies to engage in," says Michael J. Levy, head of white-collar investigation and enforcement for McKee Nelson, Washington law firm. "J&J will be well positioned to argue its conduct should not be subject to sanctions." However, it plays out, federal and state officials are likely to keep medical companies under the microscope. ■

150 cases of **ALLEGED FRAUD** by pharmaceutical companies are currently on the Justice Dept.'s docket



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ELECTRONICS

FLAT PANELS, THIN MARGINS

Rugged competition from smaller brands has made the TV sets cheaper than ever

BY PETE ENGARDIO

LIKE JUST ABOUT EVERYONE else checking out the flat-panel TVs at Best Buy in Manhattan, graphic designer Roy Gantt came in coveting a Philips, Sony, or Panasonic. But after seeing the price tags, he figured a Westinghouse might be a better buy. At \$800, the Westinghouse 32-in. set seems like a steal compared with \$950 to \$1,400 for better-known brands. Plus, the name sounds comfortably familiar. "I think they make home appliances—things like that," says Gantt.

He's right, but that's a different Westinghouse. In fact, the name didn't appear on U.S. TVs for more than three decades. Then in 2003, a startup founded by two Taiwanese-American entrepreneurs licensed the brand and distinctive W logo from CBS Corp. subsidiary Westinghouse Electric Corp. Today, Westinghouse Digital ranks No. 5 in liquid-crystal-display TVs in North America, with 7.7% of the market, according to researcher iSuppli Corp. But it is just one of more than 100 flat-panel brands jamming the aisles of retailers such as Best Buy, Target, and Costco. The names on the sets range from the obscure (Sceptre, Maxent) to the recycled (Polaroid).

The free-for-all is a boon to the millions of Americans who want to trade in their bulky analog sets. Thanks to the likes

of Westinghouse, which undercut the prices of premier brands by 20% to 40%, LCDs are no longer a luxury item. Nearly one-third of the 30 million TVs sold in North America in 2006 had LCDs, and by yearend they're expected to account for half of all TV sales. The average 27-in. LCD set now retails for less than \$650, compared with \$1,000 in early 2006, says iSuppli, while 40-in. models have plunged to about \$1,600, down from \$3,000 during the same period.

Anyone who can hold out a few months will get an even better deal: iSuppli projects that 40-in. sets will sell for less than \$1,000 by yearend, and 27-inchers may hit \$500. Sure, budget brands lack the cachet and features of a Sony or Samsung, but to most eyes the difference in picture quality is negligible. And reliability, analysts say, is improving.

For many in the industry, though, the competition is brutal. Prices for LCD sets are falling so rapidly that retailers who place orders too far in advance risk getting stuck with expensive inventory. Circuit City Stores Inc. cited plummeting prices in its Feb. 8 announcement that it will shutter nearly 70 outlets. The Asian companies that make the LCD panels that go into the TVs are getting slammed, too. Korea's LG.Philips LCD Co. attributed a \$186 million loss in the fourth quarter to the 40% drop in display prices last year. With panel prices expected to fall 20%

in 2007, the world's dozen or so makers of displays are scrambling to sell at almost any price just to generate the cash to survive. "The cuts have stressed everybody in the supply chain," says Paul Semenza, the vice-president for display research at iSuppli.

Chalk it up to the new dynamics of TV manufacturing in the age of globalization. The wide availability of standardized digital components from Asian suppliers has ushered in virtual manufacturers such as Westinghouse Digital, Vizio, and Syntax-Brilliant. In the old-line TV business, the key technologies for cathode-ray tube sets were controlled by a handful of makers who owned their own brands.

ALL OUTSOURCED

NOWADAYS, LCD MAKERS will sell to anyone, and the rest of the needed parts—tuners and computer chips—are available from multiple suppliers. Contract manufacturers will happily assemble all the pieces at factories in China, Mexico, or Taiwan. So the only thing you need to become an instant player are strong relationships with suppliers, connections at big retailers, and a handful of engineers to design the sets.

With annual sales of \$650 million and just 120 employees, Westinghouse Digital typifies the model. "When we started, we saw the whole ecology of the TV industry was changing—and saw an opportu-

THE STAT

102

LCD television brands available in the U.S., up from 26 in 2002

Data: Pacific Media Associates



," says Chief Executive Richard Houg. ed in an office park near Los Angeles, company owns no manufacturing fa- ries. What it does have is close ties with wapanese flat-panel maker Chi Mei Opto- tronics, where founder Houg once ked. Marketing? Westinghouse's ad get is virtually nonexistent: Best Buy l other retailers do most of the promo- n. "They have a business model that brought us great, low-cost products," s Mike Mohan, consumer electronics e-president at Best Buy, Westinghouse's ggest customer.

Westinghouse rival Vizio Inc. is even re spartan. The brand didn't exist ee years ago, but now it's No. 6 overall LCD sets, iSupply says, with 7% of the rth American market. Vizio has a mere full-time employees, but saw sales \$700 million last year. The private npany claims its overhead costs are t 0.7% of sales, compared with 10% 20% for big, diversified electronics glomerates, and that it gets by on fit margins of just 2%. With LCD prices falling by 3% to 5%

a month, Vizio's biggest challenge is making sure it doesn't pay too much for orders placed months in advance. The company negotiates flexible terms with suppliers and manages to keep only two weeks of inventory on hand by constantly monitoring retailers' shelves. "The critical thing is to never forecast too much or buy anything before you need to," says Vizio Marketing Vice-President Jeff Schindler, a veteran of computer maker Gateway Inc.

HEALTHY HEAVYWEIGHTS

THAT'S A BIG CHALLENGE given that Vizio says it has enough orders from retailers to sell nearly 3 million TVs this year, which would triple its revenues. If Vizio accomplishes that, it could rank among the top three brands in the U.S. Some in the industry take such forecasts with a grain of salt. "Sustaining that kind of growth will be difficult," says Rosemary Abowd, an analyst with market watcher Pacific Media Associates.

Some elite brands, meanwhile, seem

SHARP CONTRAST

Upstarts undercut big-name brands by as much as 40%

to be weathering the storm. Both Samsung and Philips have nearly doubled their U.S. share since early 2005, while Sony has held steady. Others are having a tougher time.

Sharp has seen its share of the U.S. market dwindle from 18.6% to just 12%, mostly because it was slow to bring out the huge screens that consumers crave, and Hitachi and Toshiba have also ceded ground.

The biggest players say they still enjoy decent margins because they're getting more efficient as they boost output. For that reason, most industry heavyweights have room to slash their prices further this year. "Many of the smaller brands will get squeezed during the next 12 to 18 months," says Tim Farmer, Costco Wholesale Corp.'s vice-president for merchandising.

By then, sales growth will probably slow because most consumers will have converted to digital sets. And that's when the real shakeout will begin. ■

—With Elizabeth Woyke in New York, Moon Ihlwan in Seoul, and Kenji Hall in Tokyo

AUTOMAKERS

THEY'VE DRIVEN
A FORD LATELY

Russians are snapping up its locally made models in record numbers



BY JASON BUSH

YOU WOULD THINK THE world's most successful Ford dealer might be in, say, Detroit or Los Angeles. Think again. Last year, New York Motors, on a commercial strip in southwest Moscow, sold more Fords than any other dealership in the world. All told, salesmen in the crowded showroom moved 10,060 vehicles, helping Ford race past rivals Hyundai, Toyota, and Chevrolet to become the top-selling auto nameplate in Russia. "This record has pleased and amazed everyone," says Andrey Pavlovich, general director of New York Motors. "Last year was a boom year."

The brand's success in Russia stands in striking contrast to Ford Motor Co.'s flagging fortunes elsewhere. The automaker clocked a global loss of \$12.7 billion last year, but sales of Ford-branded vehicles in Russia soared 92%, to 115,985

cars and trucks, for some \$2 billion in revenues. That's partly due to Russia's thriving economy, which has stoked strong demand for foreign models. Last year, foreign brands outsold domestic nameplates for the first time, topping 1 million—a 65% increase from 2005 and 20 times the level in 2000, according to the Association of European Businesses in Moscow.

Ford, though, has done more than simply ride the market wave. In 1999, Ford made a big bet on Russia, spending \$150 million on a plant near St. Petersburg—the country's first foreign-owned auto factory. The facility opened in 2002, and last year production climbed to 62,400 Focus sedans, hatchbacks, and wagons. "When this decision was taken, in '99, it was of

course very daring," says Henrik Nenzen, president of Ford Russia. "But Ford saw that this market would come.... And they knew that they needed to enter [it]. Ford's growing network of dealerships is helping boost sales, too. The company now has 150 outlets, some as far away as Vladivostok on the Pacific coast and Murmansk in the far north.

Ford may face a bumpier ride from here on out. Competition is heating up as rivals copy Ford's strategy of local production. Volkswagen, Toyota, Nissan, GM, and Honda have all announced plans to build plants in Russia. Worse, Ford workers in Petersburg, who earn about \$650 a month, walked off the job for one day

LATER FOR LADA Kicking tires in Moscow

Feb. 14 after rejecting an offer of a 14% to 20% raise, interest-free loans and other benefits. Talks were set to continue Feb. 15.

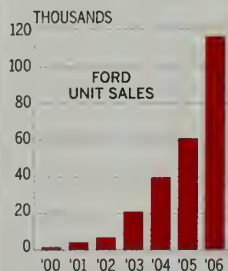
Still, local production has helped Ford keep prices down. Though about 80% of the parts used in the Focus are imported, the company sells the cars for as little as \$13,000, or about \$3,000 less than similarly equipped imports, which are subject to a 25% duty. While that's not exactly pocket change in Russia, it's low enough for a growing number of middle-class consumers. Sure, the cheapest Focus is nearly \$4,000 more than a Russian-made Lada or low-cost foreign cars such as the Renault Logan and Daewoo Nexia. But Ford says Russians are willing to spend a bit extra for a better car, and often even pony up for premium features. "The latest gadgets—the latest models, the latest technologies—that's what the Russians want," says Nenzen.

Anton Rabotonov, a 28-year-old Moscow economist kicking tires at New York Motors, agrees. After shopping around, he chose a Focus with air conditioning, antilock brakes, and air bags for \$18,999. To pay for his new wheels, Rabotonov

is taking advantage of another Ford innovation in Russia: consumer credit. Ford offers two- and three-year car loans at interest rates of just 4.9%, or a bit more than half the current inflation rate of 9%. As far as Rabotonov is concerned, it all adds up to a bargain. "I have driven Russian cars," he says. "Of course, a Ford is much more comfortable." ■

—With Anna Smolchen
in Moscow

RACING AHEAD IN RUSSIA



Data: Ford Motor Co.



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MEXICO

WRAPPING THE GLOBE IN TORTILLAS

Although Gruma faces price controls at home, worldwide production is booming

BY GERI SMITH

TORTILLAS ARE A HOT topic in Mexico these days. Since December, prices for the staple disks of corn have shot up 67%, spurring the government to impose price controls on both finished tortillas and the flour used to make them. In theory, that should be devastating for a company such as Gruma, Mexico's leading flour producer. But that's not so. While Gruma's earnings in Mexico will likely take a hit due to the controls, it is the world's No. 1 tortilla maker, and more than two-thirds of its \$3 billion-plus in sales this year will come from outside its home country.

That's because Gruma has spent years building a global market for its quintessentially Mexican comestibles. Like other Mexican giants with big international operations, such as cement-maker Cemex and cellular carrier América Móvil, Gruma has used its dominant position at home to buy brands and build plants abroad. In September, Gruma opened a

new factory in Shanghai that will churn out tens of millions of tortillas annually for KFC restaurants and other customers in China. All told, the company now produces tortillas and chips in 89 factories from Australia to Britain.

Gruma made its first move north of the Rio Grande 30 years ago. The company has been supplying KFC's sister chain Taco Bell Corp. for more than 20 years, and agribusiness giant Archer Daniels Midland bought 27% of Gruma in 1996. But Gruma's global expansion is now speeding up, thanks to CEO Jairo Senise, 51, a Brazilian who formerly ran the European division of General Mills Inc. He joined the company in 2002 as head of U.S. and European operations, and quickly ordered Gruma's U.S. brands, Mission and Guerrero, to launch dozens of new styles of tortillas such as cilantro-onion and

LOCAL FACILITIES are helping Gruma meet demand from California to China

Omega-3 fortified. After getting the top job last year, he took a month-long trip

with stops in cities from Manila to Moscow sampling food in local markets with an eye toward producing tortillas that might fit the local fare. "We're able to think globally but respect the tastes and preferences of each country where we operate," Senise says.

A CORNERED MARKET?

THE SHANGHAI PLANT IS a key part of Gruma's global expansion. The company built the facility at the request of KFC, which had been importing frozen Gruma tortillas from California for the chicken wrap sandwiches it offers in more than 1,800 restaurants in China. "We asked [Gruma] to localize, and they did," says Joaquin Pelaez, who oversees China operations for KFC's parent company, Yum Brands Inc. Gruma plans to begin exporting Shanghai-made tortillas to other Asian markets this year.

The company's international operations seem to be running more smoothly than those at home. That's because of the price controls, which the government introduced on Jan. 18 after the cost of imported corn soared. Gruma, which supplies 75% of Mexico's corn flour for tortillas, had to agree to keep a lid on its prices. As a result, Merrill Lynch & Co. predicts Gruma will earn \$111 million on \$3.1 billion in sales this year, vs. estimated profits of \$145 million and revenues of \$2.85 billion in 2006. Gruma's shares, which trade on the Mexican and New York exchanges, are down 6.8% so far this year. In the U.S., meanwhile, rivals grouse that Gruma has gotten so big it crowds out the competition, though a lawsuit to that effect was thrown out of a federal court in Texas in 2004.

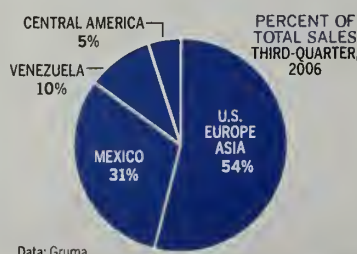
Senise is now eyeing opportunities in South Africa, Morocco, Egypt, and India. And he'd like to move into industrial tortilla production at home, where mom-and-pop tortillerias domi-

nate the market and Gruma mainly sells flour. That could be tough. Today, Gruma makes tortillas only in a few cities, and Mexico's antimonopoly watchdog may not allow it to expand. Still, says Senise, "the market in Mexico is huge."

—With Michael Arndt in Chicago

BIG ENCHILADA

Gruma's worldwide reach



Data: Gruma

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CAREERS

MAJORING IN
LA DOLCE VITA

B-school training in luxury retailing is part brand management, part finishing school



FIELD TRIP MBAs
get a feel for the
goods

BY CAROL MATLACK

VIRGINIA WRIGHT, A self-described fashion junkie from Atlanta, would be the first to admit that she had a blast attending a week of runway shows in Paris last fall. Not that it was all pleasure, mind you. Wright is pursuing an MBA in luxury brand management at ESSEC, a business school outside Paris, and the shows were part of her course work. "I'm getting all the benefits of a general MBA with this amazing extra layer," Wright says.

Savoir faire in selling expensive stuff is the newest Old World export. To position themselves as gateways to the \$90 billion global luxury goods trade, European business schools are blending traditional fare such as finance and accounting with

specialized courses in luxury retailing and brand management. In class, students complete case studies on industry heavyweights, learning, for instance, the importance of an aura of exclusivity after concluding that Polo Ralph Lauren lost cachet by opening too many outlet stores. That sort of work is topped off with field trips to, say, Italian leather goods factories or Swiss watchmakers' workshops. Students even learn to evaluate gemstones under a loupe, and to taste and serve fine wines. "If you're going to manage a luxury brand, you have to have a certain level of culture," says Alice Riese Rolley, a student from Germany.

Sounds like fun, but these programs fill an urgent need. With sales growing 11% an-

nually, the industry is hungry for talent. "In China alone, we will hire probably 1,000 managers in the next five years," says Concetta Lanciaux, human resources chief of Paris-based LVMH Moët Hennessy Louis Vuitton. Traditionally, most luxury houses were family-run. Today, though, the business is increasingly dominated by conglomerates such as LVMH and Guccio Group. "There's a real need for people with an international profile who understand the luxury world from inside," says Florian de St. Pierre, a headhunter in Paris.

PERKS, NOT PAY

MOST GRADUATES OF ESSEC's program now in its 11th year, quickly land jobs at companies ranging from Christian Dior Couture to diamond seller DeBeers and penmaker Montblanc. Initially, most students came from Europe and Japan. But growth has shifted to developing Asia and the U.S., more than two-thirds now hail from those regions. ESSEC says it accepts only a third of applicants for the 30 or so slots in its 11-month program.

Rival schools want a piece of the action. The International University of Monaco and French B-school HEC both launched luxury management programs in September. HEC even holds its classes in Beijing, to meet strong demand there. About half the faculty members commute from France, and students spend eight days in Paris for a cultural immersion crash course. "It's about learning how to create a product strategy, how to communicate," says Wendy Han, a student in HEC's Beijing program who hopes to launch her own fashion brand.

Many students are looking for a career change. ESSEC alumni include a former Ford Motor Co. engineer who now works for Prada, and a research manager from Nestlé who joined Bulgari. Students rave about the contacts they develop with luxury company executives, who give guest lectures and volunteer as mentors. Such access makes ESSEC's \$36,000 tuition "a great deal," says Wright, a former public relations executive who hopes to land a fashion marketing job in the U.S.

Fashion shows, fine wine, but lower starting salaries

A year in Paris, living the champagne-and-caviar lifestyle, hobnobbing with makers of chic bags, shoes, and watches—is there a catch? Well, starting salaries in luxury are usually lower than in finance, consulting, and other areas that recruit MBAs. But, says Ketty Maisonneuve, a New York-based luxury goods consultant, "Students are willing to take a pay cut to enter this field."

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Get Healthy—or Else

Inside one company's all-out attack on medical costs

BY MICHELLE CONLIN

IN AUGUST, JOE PELLEGRINI got yet another nagging phone call. It was his health coach, a woman working on behalf of his employer, the \$2.7 billion lawn-care company, Scotts Miracle-Gro Co. The 48-year-old executive knew the spiel by heart. “Have you been to your doctor yet? When are you going?” Then the prescription: “You need to lose weight and you really, really need to lower your cholesterol.”

Pellegrini is a supply-chain executive at Scotts' headquarters in Marysville, Ohio, a land of all-you-can-eat buffets smack in the middle of America's obesity belt. At Scotts the hallways are filled with LDL-abusers and overweight diabetics. Pellegrini, by contrast, is an Armani-swaddled triathlete who often cycles 36 miles to and from work. Lose weight? “Give me a break,” he thought. “It's all muscle, folks.”

But a time bomb was ticking beneath the taut physique. Medical specialists working on behalf of Scotts had been scouring every aspect of Pellegrini's health. His profile—athletic, high body-mass index, and bad cholesterol (brought on by a love of 28-ounce sirloins)—triggered an alarm.

Eventually, Pellegrini succumbed to the company-applied pressure and agreed to abide by his health coach's action plan, which included an immediate visit to his doctor. A few weeks

“ If people understand the facts and still choose to smoke, it's suicidal. And we can't encourage suicidal behavior.”

JIM HAGEDORN Scotts' CEO acknowledges that the company's wellness program is controversial



later, a specialist studying Pellegrini's angiogram spotted the heart valve of what should have been a dead man. Within hours, two stents were installed. The surgeons later told him the 95% blockage would have killed him within five days. "It was that close," Pellegrini says.

About the time Pellegrini was cheating death, a lawn-care technician named Scott Rodrigues was having an entirely different experience with the Scotts wellness program. At the time, Rodrigues says he had been working at the company for about two weeks. He recalls a supervisor approaching him in the parking lot at the company's Cape Cod (Mass.) facility and urging him to get rid of the pack of Marlboro reds poking out of the dashboard of his decrepit Civic.

Rodrigues knew Scotts was going tobacco-free on Oct. 1 as part of its effort to improve employee health and cut medical costs. He recalls the company's interviewer saying that once Rodrigues passed the 60-day probation, Scotts would help him quit his 15-year habit—paying for counseling, Nicorette, prescription drugs, hypnosis. Whatever it took.

But on Sept. 1—which happened to be his 30th birthday—Rodrigues was fired. "Why?" he asked. "You failed your drug test," the boss replied. Rodrigues insisted it had to be a mistake. He didn't even keep beer in the fridge. Then his boss told him the drug was nicotine. "Five years ago, if you had told me, 'Hey, you better quit smoking or you might not get a job,' I would have laughed. Here I am five years later, and I can't get a job."

In November, Rodrigues filed a lawsuit, now in federal court in Massachusetts. It alleges that Scotts discriminated against Rodrigues by firing him before he was eligible for health-care benefits and had a chance to take advantage of the stop-smoking initiative. The suit also seeks to prohibit Scotts from "enforcing or applying" its anti-nicotine program. The company hopes to have the suit dismissed. Citing its policy of not discussing pending litigation, Scotts declined to comment on the lawsuit.

TWO STORIES—ONE MAN SAVED BY the 11th-hour intervention of his employer; another fired on his 30th birthday for smoking—capture the dilemma facing companies around the country. How do executives looking to cut medical costs persuade employees to take better care of themselves without killing morale and spawning lawsuits? It's a question that's very much on the mind of Scotts CEO Jim Hagedorn, who acknowledges his company's wellness program is controversial. "Jack Welch told me: 'Man, you have balls of steel,'" says Hagedorn. "This is an area where CEOs are afraid to go. A lot of people are watching to see how badly we get sued."

Getting health insurance from your employer is sometimes seen as an entitlement, but the benefit owes its existence to a quirk of history. During World War II, employers desperate to attract workers began offering health insurance. Providing coverage has been an increasing burden for companies ever since. As a result, businesses have been forcing employees to shoulder more and more of the cost.

Some theorized that higher co-payments and pricier premiums would get people to take better care of themselves. It's



“Give me a break,” he thought. “It’s all muscle, folks.”

JOE PELLEGRINI A triathlete who often bikes to work, he nevertheless had dangerously high cholesterol. Scotts got him help just in time

not happening. "We have this notion that you can gorge on hot dogs, be in a pie-eating contest, and drink every day, and society will take care of you," says Harvard Business School Professor Michael E. Porter, who co-authored *Redefining Health Care*. "We can't afford to let individuals drive up costs because they're not willing to address their health problems."

Hence the wellness fixation at companies as varied as IBM, Microsoft, Harrah's Entertainment, and Scotts. Employees who voluntarily sign up for such programs often receive discounts on health-care premiums, free weight-loss and smoking-cessation programs, gratis gym memberships, counseling for emotional problems, and prizes like vacations or points that can be redeemed for gift cards.

Companies save money. Employees get healthier. What not to like? But the wellness craze raises important issues. One is that people could start blaming unhealthy colleagues for helping push up premiums. Then there are the privacy and discrimination issues: How far should managers intrude into employees' lives? That's the essence of the Rodrigues lawsuit.

U.S. business has long evinced a paternalistic streak. Early last century, Ford Motor Co. sent investigators to workers' homes to make sure their sex lives were "unblemished" and they weren't imbibing one too many. Today, Scotts is in the vanguard of companies seeking to monitor and change employee behavior. The



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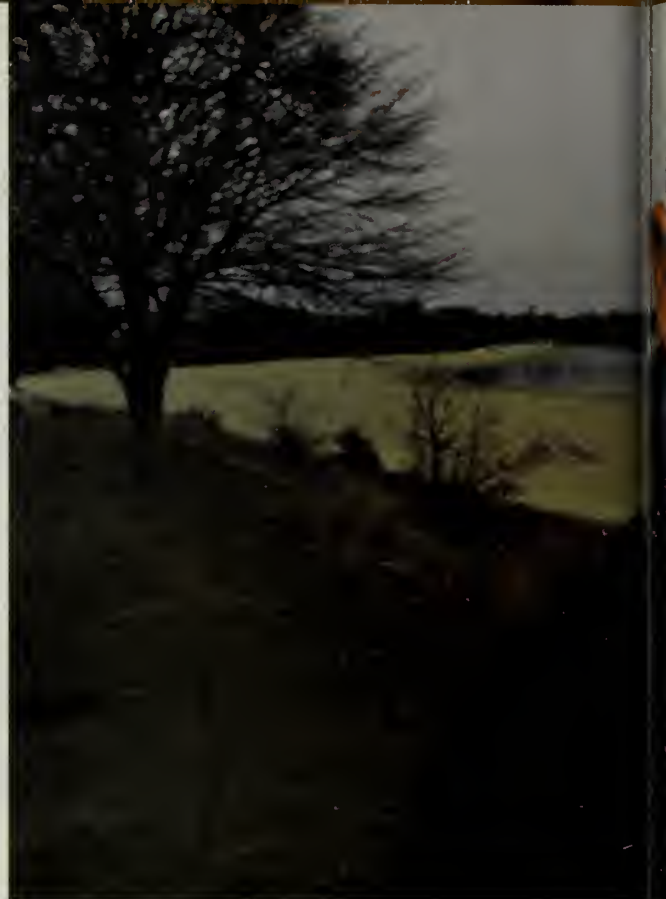
Data: Henry J. Kaiser Family Foundation

company's outlier status reflects the born-again zeal of its CEO. Hagedorn is a reformed nicotine addict himself. He smoked two packs a day for 20 years—until his mother, also a heavy smoker, died of lung cancer. Hagedorn quit the same day.

In the early 2000s, Hagedorn, like many other CEOs, watched health-care costs explode. From what he could see, the government and the health-insurance industry weren't doing anything to solve the crisis. At the same time, Hagedorn's employees were bingeing on care.

In February, 2003, Scotts doubled what workers paid for health insurance. Morale plummeted, and Hagedorn knew he had to do a better job selling the hike. Hagedorn is famous at Scotts for the "straight talk" sessions he holds with staff each quarter. A former F-16 fighter pilot who retains much of his military bravura, Hagedorn laces his sermons with salty language and unvarnished commentary. The CEO got right to the point: We were boneheaded, he told the crowd.

Then again, Hagedorn wanted employees to know what he was



up against. Using a PowerPoint presentation, he showed that his annual health-care bill had soared 42% since 1999, to \$20 million, which amounted to 20% of the company's net profits in 2003. Costs were projected to surge about 20% that year, vs. the national average of 9%, and keep on climbing at a double-digit rate.

TOWARD THE END OF THE talk, a young plant worker stood up and scolded Hagedorn. "You guys on the other side of the street, you got fancy financial advisers," he said. "How can you make me responsible for managing my finances and health care and not educate me? I only have a high school education." Hagedorn left the meeting thinking: "The guy's right."

A few months later, Hagedorn was watching CNN. A doctor was arguing that employers should get serious about obesity, smoking, and diabetes. Companies were paying the bills, he said, so they could do something. As it happens, Hagedorn had recently seen Scotts' health-risk assessment: Half of his 6,000 employees

up and coming

down and out



“Five years ago if you had told me, ‘Hey, you better quit smoking or you might not get a job,’ I would have laughed. Here I am five years later, and I can’t get a job.”

SCOTT RODRIGUES Fired on his 30th birthday for being a smoker, the former Scotts employee is suing the company

ere overweight or morbidly obese; a quarter of them smoked. The CNN program prompted an epiphany. Hagedorn wanted to share it right away with his human resources chief, Denise Stump. It was after 11 p.m., but he called her at home anyway. “Denise,” he said, “we are moving into FEBA [forward-edge battle area].” Hagedorn told her he wanted to ban smoking and go after obesity. To achieve these aims, he proposed launching the kind of companywide intervention that families use to help an addicted relative.

Instituting such a policy wasn’t a matter of saying, “Let it be.” Legal worried the plan might violate federal laws. Other advisers told the CEO point blank: Don’t go there. And getting outside advice wasn’t going to be easy. Many law firms were knee-deep in tobacco litigation and wouldn’t go near Scotts’ wellness initiative. Nor would board member Lynn Beasley, chief operating officer for tobacco maker R.J. Reynolds. Beasley saw the conflict right away and quit the Scotts board. Stump recalls thinking: “We’re going too fast.”

Hagedorn isn’t easily dissuaded. The 51-year-old CEO talks like a swaggering teenager, with “yo” this and “dude” that. A runaway at 15, Hagedorn still flies his rebel flag: A photo in his office features him giving the middle-finger salute.

Needless to say, Hagedorn got his way. Scotts hired a boutique law firm. And before long, the company had determined that in 21 states, including home-base Ohio, it wasn’t illegal to hire and fire people based on their smoking habits. Scotts also realized it needed to create an arm’s-length relationship with the wellness program. No one wanted to give managers an opportunity to discriminate against employees based on their health. That meant bringing in a third party to run the thing.

In 2005, Scotts hired Whole Health Management. The firm manages on-site primary care and fitness centers for dozens of corporations. Whole Health aggregates health and insurance claim data so Scotts can divine trends. But individual data are kept strictly confidential. Stump began selling the concept to employees. She held role-playing sessions to teach workers

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what to say if they bumped into each other in the clinic. On-site doctors told employees they would never betray confidences.

During one of Hagedorn's straight-talk sessions, workers told him a company gym would make wellness easier to swallow. "Done," Hagedorn said. But his vision went far beyond installing some StairMasters and throwing up health pointers on the Scotts intranet. Hagedorn built a soup-to-nuts medical and fitness center across the street from headquarters. Operated by Whole Health, the 24,000-square-foot facility cost \$5 million and can meet pretty much any health-related need an employee might have, including a drive-thru for free prescription drugs. The clinic employs two full-time doctors, five nurses, a dietician, counselor, and two physical therapists. A team of fitness coaches provides personal training sessions for \$30 an hour.

SCOTTS EMPLOYEES ARE NOW URGED to take exhaustive health-risk assessments. Those who balk pay \$40 a month more in premiums. Using data-mining software, Whole Health analysts scour the physical, mental, and family health histories of nearly every employee and cross-reference that information with insurance-claims data. Health coaches identify which employees are at moderate to high risk. All of them are assigned a health coach who draws up an action plan. Those who don't comply pay \$67 a month on top of the \$40. "We tried carrots,"

says Benefits Chief Pam Kuryla. "Carrots didn't work."

Many employees found Hagedorn's new policy intrusive. Topic A: the health assessment questionnaires, which asked things like: Do you smoke? Drink? What did your parents die of? Do you feel down, sad, hopeless? Burned out? How is your relationship with your spouse? Your kids? Are you pregnant diabetic, suffering from high cholesterol? The tobacco bar was controversial, too, especially at the manufacturing plants where Skoal chewers are common. Hagedorn wasn't unsympathetic. After all, it took his own wife three years to quit smoking. Scotts employees would get all the help they needed.

Workers told the CEO they were angry. Hagedorn concedes the program had Big Brother overtones. But he's adamant about bringing down health costs—even if it means being authoritarian. "If people understand the facts and still choose to smoke, it's suicidal," he says. "And we can't encourage suicidal behavior."

As chief wellness salesman, Hagedorn took it upon himself to motivate employees. He walks around campus joking, slapping guts, and exhorting people to work out. Hagedorn routinely teases Dave Overfield, who toils in the plant and whose weight has soared 40 pounds since he quit chewing tobacco.

"I'm working on it," Overfield tells his boss.

“I’m not trying to be Hercules. But as you can see, there’s not a lot of flab.”

JIM LOWE By sticking to the wellness program at Scotts, the forklift driver met his goal of losing 137 pounds

"You better be," Hagedorn shoots back.

The nudging begets peer pressure. Gym rats earn special pins they display on ID badge lanyards; these have become a coveted status object. Competition for trips to Hawaii, free massages and facials, and other cash and prizes is fierce. One group of employees started having lunch together every day to keep each other from peeling out of the parking lot for a smoke. Doughnuts have disappeared. "The message is: 'If you're not trying to do something to make yourself better, then you're going to pay more,'" says Kuryla.

Jim Lowe gets that. The 54-year-old forklift driver loved to eat. He started each day with two doughnuts. Lunch was a pair of Whoppers and fries. Nighttime involved a bag of chips, a couch, and a clicker. Lowe's philosophy was simple: "Let's don't go to a place that'll serve us a helping. Let's go to a buffet where you can eat all you want." He weighed 307 pounds.

He was the perfect candidate for the wellness crusade. Before long a dietician was telling Lowe exactly what to eat, and a personal trainer was showing him exactly how to work out. Soon Lowe was losing an average of four pounds a week. Co-workers at the plant began asking if he was taking diet pills. They gossiped that he had had gastric bypass surgery. Lowe proudly told them he was doing it "natural, working out and watching what I eat."

Lowe had always loved the way Wrangler jeans hung on his

Continued on page 69

Innovation

The Key to Business Growth

Collaboration and co-operation through innovation networks

Corporations today are pursuing a globally-distributed, network approach to innovation. Current university programs and company R&D activities reach across borders in search of collaborative partnerships. Companies can most easily reap the rewards of innovation through a global ecosystem in which firms, universities, and governments work together.

Ireland's innovation landscape

Ireland's innovation landscape thrives on the importance of human connections. Irish business policy brings together - in a unique, no-nonsense and highly pragmatic way - a wide range of national institutions to help create leading edge research programs.

Government, funding agencies, regulatory authorities, academia and industry are constantly working as a national team, creating a fast-growing, dynamic research environment.

The result of this high-level connectivity is that Ireland has become one of the new global centers for science- and innovation-based R&D. Ireland is empowering some of the world's biggest companies to research, develop and commercialize world-class products, processes and services.

Long-established partnerships with global corporations have been at the core of Ireland's success in attracting leading edge R&D activities. Despite Ireland's small size geographically, its energetic, knowledge-based economy wins a disproportionate amount of Europe's R&D centers.

In 2006 Ireland's inward investment agency, IDA Ireland, supported 54 R&D investment projects. The past year has seen R&D announcements by many prominent global corporations. The names speak for themselves: CISCO, GlaxoSmithKline, PepsiCo, Intel, IBM, Bristol-Myers Squibb. These corporations are actively supported by renowned global research organizations located in Ireland, such as Georgia Tech Research Institute and Bell Labs.

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Joining forces for innovation

Ireland is the surprise leader in a ranking of how far 26 industrialized countries benefit from a trend towards 'innovation networks' - partnerships between companies or countries which are thought to be more effective than keeping research and development to oneself.

Countries placed towards the right of the chart are deemed to be strong on strategy, with those towards the top considered to have a strong current offering. Countries not falling into the three bands ('contenders', 'strong performers' or 'leaders') are judged to be 'risky bets'. The size of the dot indicating each country's position denotes its presence in the world market.

The study, carried out by the US research consultancy Forrester, identifies 'transformers' - countries that are effective at taking developments from other nations or companies and turning them into commercial products.


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$oObj = array();
return $oObj;

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An integrated, collaborative strategy

The Irish Government pursues a carefully planned, integrated R&D strategy encompassing all of the key elements necessary to achieve world-class R&D. Its \$5 billion Strategy for Science, Technology and Innovation will double the number of Ph.D. graduates and attract future generations of well-educated young people into research careers in knowledge-driven companies. It will substantially extend the physical infrastructure to support them. And, for the first time ever, eight government departments will co-ordinate all activity in relation to science, technology and innovation.

IDA Ireland is one of the main players behind the new wave of national, collaborative R&D activity. It works closely with Science Foundation Ireland (SFI), the agency which consolidates links between industrial and academic research and funds such research. IDA Ireland and SFI have developed a range of new initiatives to encourage pooled projects and attract world-class scientists to carry out research in Ireland.

This inclusive way of bringing together industry and academia has led to a boom in research projects. More than 10,000 researchers are working on cutting edge R&D projects in Ireland. Many of them have relocated from the US, Canada, Japan, the UK, Switzerland and Belgium.

Ireland's Centers for Science, Engineering & Technology ('CSETs') link scientists and engineers in partnerships across academia and industry. One such CSET is CRANN, the Centre for Research on Adaptive Nanostructures & Nanodevices. CRANN's mission is to advance the frontiers of nanoscience. It provides the physical and intellectual environment for world-class fundamental research, and has partners in Irish and overseas universities.

"We couldn't be more delighted with the output of our Irish operation. The Irish Government understands the factors affecting business better than virtually any other country."

Microsoft CEO,
Steve Ballmer.

Ireland's young workforce has shown a particular flair for collecting, interpreting and disseminating research information.



"The Government's approach to science, technology and innovation will enable us to take the policy decisions which are necessary to see Ireland realize its full potential as a knowledge economy."

Irish Prime Minister, Bertie Ahern.

Tax and intellectual property

Ireland's intellectual property laws provide companies with generous incentives to innovate. The Irish tax system offers huge support to turn brilliant ideas into the finished article. A highly competitive corporate tax rate of 12.5% is a major incentive. No tax is paid on earnings from intellectual property where the underlying R&D work was carried out in Ireland.

Ireland recently introduced a new R&D Tax Credit, designed to encourage companies to undertake new and/or additional R&D activity in Ireland. It covers wages, related overheads, plant/machinery, and buildings. Stamp duty on intellectual property rights has been abolished.

People skills

The IMD World Competitiveness Yearbook 2006 rates Ireland's education system as one of the world's best in meeting the needs of a competitive economy. It also ranks the Irish workforce as one of the most flexible, adaptable and motivated.

Ireland's young workforce has shown a particular flair for collecting, interpreting and disseminating research information. Major investment in education has provided a skilled, well-educated workforce; Ireland has more than twice the US/European per capita average in science and engineering graduates.

A track record of success

Ireland's success in innovation spans a wide range of businesses and sectors. For example, some of the most exciting Irish-based product development has been in medical technologies. Over half of all the medical technologies companies based in Ireland have dedicated R&D centers.

Boston Scientific researched and developed the world's first ever drug-coated stent using researchers in Ireland. **Bristol-Myers Squibb's** Swords Laboratories is the launch site for several new healthcare treatments used to treat hypertension, cancer and HIV/AIDS.

GlaxoSmithKline's latest Irish R&D project involves groundbreaking research into gastrointestinal diseases, in collaboration with the Alimentary Pharmabiotic Centre in University College Cork.

Recently **Microsoft** marked its 20th Irish anniversary by opening a new R&D center,

creating 100 new jobs. The centre is working on a wide range of projects, including Digital Video Broadcasting (DVB) and SmartCard security technology.

Intel, a significant supporter of education and training in Ireland, is engaged in several research collaborations with leading Irish universities, including Trinity College Dublin, University College Cork and Dublin City University. Intel's Irish operation is the global headquarters for the company's Innovation Centres.

Analog Devices' long established R&D operation is heavily integrated into its Irish operation. Its 335-strong team has sole responsibility for the global design, manufacture and supply of value added high voltage, mixed signal CMOS products.

An exciting future of world-class innovation

Lucent Technologies' Bell Labs, one of the world's most eminent research institutions, has established its Center for Telecommunications Value-Chain-Driven Research in partnership with Trinity College Dublin. It will undertake research aimed at realizing the next generation of telecommunications networks.

Georgia Tech Research Institute's new Irish operation will be a critical component of Ireland's innovation infrastructure. It plans to build up a portfolio of research programs and collaborations with industry which at full operation will employ 50 highly qualified researchers.

Wyeth is establishing a bio-therapeutic drug discovery and development research facility at University College Dublin. It will utilize new technologies to discover the next generation of therapeutic biopharmaceuticals for the treatment of a wide variety of diseases.

At an academic level, just one illustration of the integration in R&D activity in Ireland is Dublin City University's Biomedical Diagnostics Institute. It is carrying out cutting-edge research programs focused on the development of next-generation biomedical diagnostic devices.

Ireland's success is based on a culture of co-operation and collaboration to win complex, high value, sophisticated investments. The country's strong business philosophy of inclusiveness, informality and teamwork are the foundations on which Ireland is fast becoming an important player in the development of global innovation networks.

Louis le Brocqy, artist.
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“I was afraid we were going too fast.”

DENISE STUMP The human resources manager helped sell the wellness program to Scotts employees

for using tobacco. In fact, because Rodrigues wasn't employed long enough to pass the probation period, the company argues that he was never officially an employee.

It's impossible to tell how the case will come out because there is so little case law. This much is certain: Rodrigues' lawyer, Harvey A. Schwartz, will argue that Scotts' wellness program amounts to a slippery slope. "Where will all this end?" he asks. "The consumption of alcohol, failure to exercise, skydiving, excessive television viewing, eating processed sugars, owning dangerous pets, flying private aircraft, mountain climbing, downhill ski racing, singlehanded sailing, or spreading toxic chemicals on lawns?"

Where will it all end? Companies ask themselves the same question but from a different angle. In the absence of a solution to the health-care mess, businesses are on an unsustainable path. Hence the rush into wellness. Perhaps that's why Hagedorn is getting leeway from shareholders, including his own family, which controls 30% of the public shares. The stock is up 58% since Scotts launched its wellness program. If Hagedorn pulls this off, he'll be a hero in boardrooms around the country. ■

BusinessWeek .com

www.businessweek.com/extras

CUTTING COSTS THROUGH WELLNESS

ONLINE: A "Straight Talk" with CEO Hagedorn on the perils of smoking, rising health-care costs, and the controversial nature of Scotts' program.

PODCAST: The Story Behind the Story Executive Editor John A. Byrne talks to Senior Writer Michelle Conlin at businessweek.com/search/podcasting.htm.

PLAYBOOK: BEST-PRACTICE IDEAS

How to Launch a Wellness Program

Thomas B. Gilliam, co-author of *Move It. Lose It. Live Healthy: Achieve a Healthier Workplace One Employee at a Time*, shares five tips.

Be Inclusive

Don't just single out obese people. Choose a program that emphasizes the benefits of lifestyle change—whose principles center on healthful, nutritious foods and regular exercise—and everyone will benefit. "Fitness" and "thinness" are not always synonymous.

Be Honest

Tell employees it's difficult to provide higher wages and better benefits when so much money is going to support preventable illnesses. And don't discount the power of face-to-face conversations. People will respect you more if you look them in the eye.

Offer Incentives

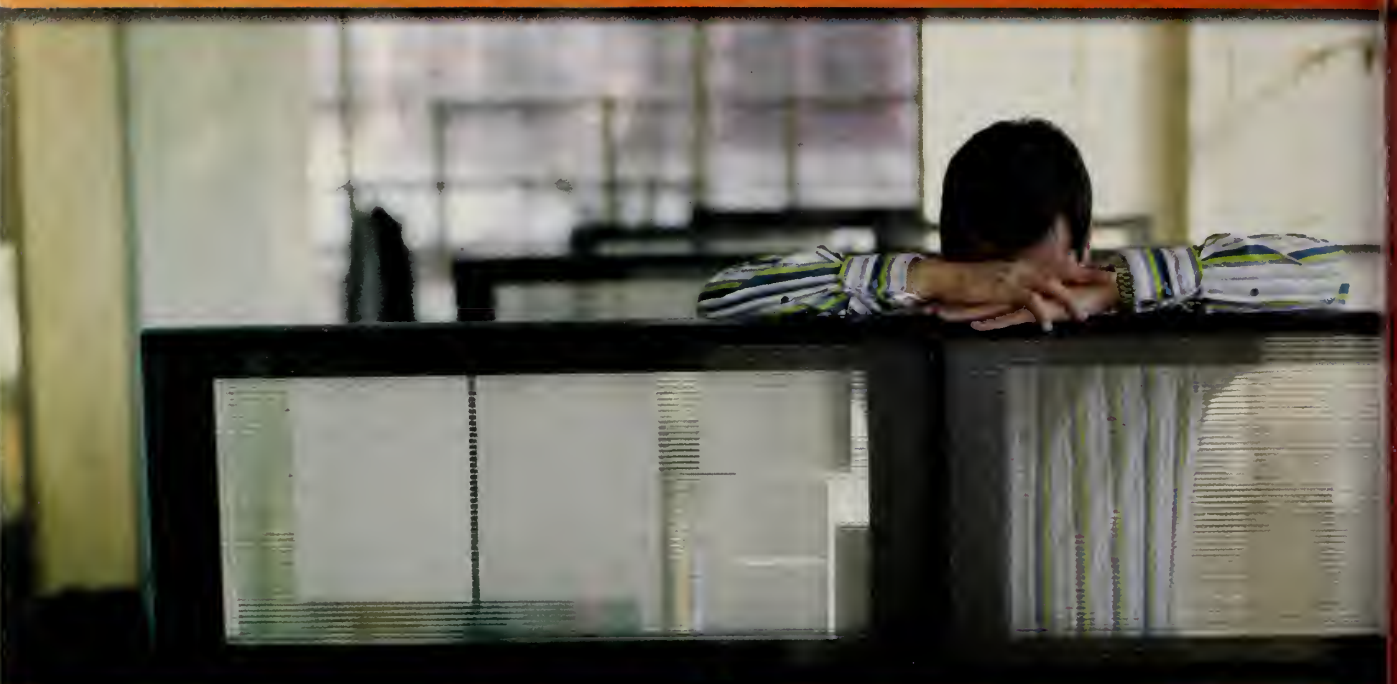
These can vary wildly. Some companies hand out small cash bonuses or gift certificates for reaching predetermined milestones. Others offer discounted insurance premiums. Still others make it a "team thing" and set up competitions between departments.

Foster Exercise Groups

Human beings are much more likely to sustain an exercise program if they have company. Hire an aerobics instructor to come in several times a week—to lead everyone in a vigorous workout. Start a lunch-hour walking group. You might even build a gym.

Use Family As a Lever

Offering to help employees set a healthy example for their children can be a powerful motivator. "When you say to people, 'Look, every time you open a new bag of potato chips and collapse in front of the TV, your kids are watching you,' they pay attention," says Gilliam. "Hey, guilt can be a very useful tool."



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**THE 21ST
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Meeting

Beam them up, Scotty:
The latest gear
may finally deliver
on the promise of
videoconferencing

BY ROGER O. CROCKETT

WE'VE ALL BEEN THERE: You're sitting at a conference table staring at a black phone box. After months of 12-hour workdays and sleepless nights, the fate of Project Breakthrough hangs on this one conference call. Nervous as a schoolkid before his first spelling bee, you bark out your best pitch. Silence. In these awkward seconds of quiet, you're left only to imagine what's happening on the other end: Furrowed brows? Turned-up noses? Or heads nodding at your trenchant wisdom?

This is when you wish you had sprung for that \$2,500 ticket on the red-eye. Because even the most effective conference call can't convey everything you need to say or hear or feel in a do-or-die business meeting.

Take it from the scientists. Thirty-seven years ago, the late anthropologist and professor of communications R. L. Birdwhistell demonstrated that less than 35% of the message in a conversation is conveyed by spoken words—the other 65% is communicated with facial expressions and body language. Says Matthew Lombard, a professor at Temple University and president of the International Society for Presence Research: "Without the visual, you miss most of the nonverbal cues."

So it was no wonder that hopes soared last year when several tech outfits rolled out new videoconferencing equipment that promised to fill in those blanks. The systems from the likes of Hewlett-Packard, Cisco Systems, and Polycom seem like nothing less than a conference-room equivalent of Star Trek's Holodeck. Taking advantage of breakthroughs in video, audio, and broadband technologies, they purport to create experiences so lifelike that participants who are thousands of miles apart look (and more important,





TAKING A MEETING
A DreamWorks team discusses the sequel to *Madagascar*

Losing The Static

A new generation of videoconferencing systems takes advantage of advanced video, audio, and transmission technologies to deliver a lifelike meeting experience. Here's a look behind the "telepresence" systems.



CAMERAS

Three cameras at the front of the room (set in the monitors)

capture images, which are compressed and transmitted across miles. Then they are decompressed for viewing. This all happens in 200 milliseconds.



MONITORS

Up to three 50- to 65-in. plasma screens

typically depict six people on the other end in full-motion, high-def video at 30 frames per second. A fourth monitor lets users view documents simultaneously.



MICROPHONES

Three tiny, ultrasensitive mikes in the conference

table pick up voices and block out noise. Sound is perfectly synced to visual movements, and people can be heard simultaneously in different parts of the room.



AESTHETICS

Recreating the conference room experience is crucial, so the

curve of the table is replicated on-screen, colors on the screen match those in the room, and light is directed so that people on-screen are not washed out.

feel) like they're in the same room. "This is the next big thing," says Craig Malloy, CEO of LifeSize Communications Inc., which produced one of the first high-definition video systems. "It fills the gap between absolutely-gotta-be-there-and-drink-a-beer meetings and a regular old phone call."

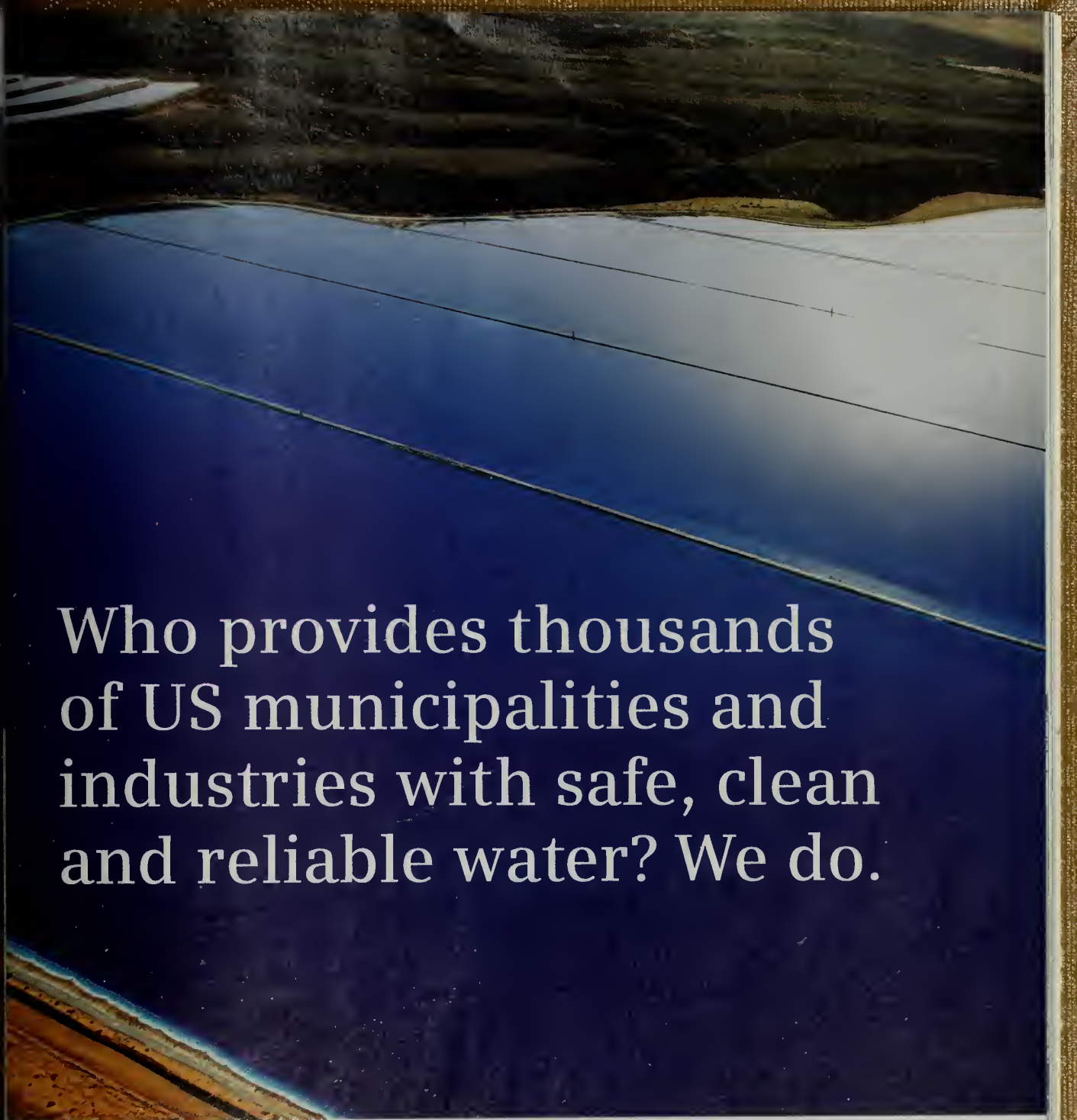
BACK TO THE FUTURE

THE EFFECT IS TO create an illusion of seamlessness between the viewer and the viewed. Hewlett-Packard's Halo system and Cisco's TelePresence 3000 use massive 50- to 65-in. high-definition screens to show people sitting behind a conference table that's identical in color and shape to the one used by the viewers. Polycom, a longtime leader in conventional conferencing equipment, started selling in January its own advanced lifelike system, only bigger and more elaborate,

with 8-ft.-wide screens. That sense is reinforced by advanced audio that lets everyone talk at once without canceling out all voices. Get up and walk across the room, and for those on the other end your voice travels with you.

But wait. Haven't we heard before that videoconferencing was going to make business travel obsolete? Many times, in fact. Few fields have proved so susceptible to hype. The example that first comes to mind is the Picturephone that AT&T showed at the 1964 World's Fair, only to quash it a few years later in the face of weak demand. There are plenty of others.

So is there any reason to believe this new gear, broadly referred to as "telepresence" systems by the industry, will come closer to changing the business meeting as we know it—or even replacing a few business-class tickets? To find out, *BusinessWeek* traveled, virtually and literally, to some of the outfi



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Videoconferencing: A Call Still Waiting

For years inventors have promoted systems to replace face-to-face meetings, only to disappoint.

1927 Then-Commerce Secretary Herbert Hoover (above) places first videoconference call from Washington to the president of AT&T in New York. Although innovative, the system was bigger than two jumbo-size refrigerators.

1964 At the World's Fair in New York, AT&T demonstrates the "Picturephone," a telephone with a black-and-white screen allowing callers to see each other (right). AT&T launches the service in Pittsburgh six years later. Despite predictions of a million sets in use by 1980, consumers balk, finding it too pricey. AT&T pulls the plug.



1991 PictureTel, a subsidiary of IBM, unveils the first PC-based videoconferencing system that lets users see others in full-motion, color video from their desktop. But it is difficult to use and costs well over \$1,000.

1997 Researchers at California Institute of Technology introduce the Virtual Room Videoconferencing System, elevating video calls from a desktop experience to a full-room concept. It is used extensively by scientists, and will finally be selling commercially in March.

2001 Video begins to revolutionize some fields, as doctors conduct the first transatlantic tele-surgery and TV reporters use satellite-powered videophones to cover events. But costs remain high, and installation is still a headache.

that have plunged into this videoconferencing revolution took their systems for a spin.

The first thing to know about the early adopters is that there are no outposts in an office park—they have serious green spend. While basic systems cost \$8,000 per room, the price for more elaborate displays can soar to \$392,000 for a room with network management fees that can range from \$6,000 to \$18,000 a month.

'THIS IS INTENSE'

A TYPICAL USER IS PRIVATE equity star Blackstone Group. Several times a week, CEO Stephen A. Schwarzman gathers senior managing partners around a polished conference table in the firm's New York headquarters on Park Avenue for a five-way video call to talk about the sale of some real estate in the Northwest, say, or a bid for Tribune Co. On three wide, glistening, high-definition color screens appear executives from Blackstone's offices in such far-flung places as London, Hong Kong, Mumbai, or Paris. Blackstone has 40 video rooms stationed around the world. One executive is so enthralled with the system that he keeps the conference connection running in his office all day long. "We're big proponents of videoconferencing because of the way it enhances the quality of meetings," says Harry D. Moseley, Blackstone's chief information officer.

Financial and consulting firms have been particular avid purchasers. Deloitte & Touche USA is installing a dozen \$250,000 video suites made by Polycom so that various business units can collaborate on outsourcing ideas or interview candidates from India. AIC Ventures, a real estate investment company, has three video rooms: one at its home base of Austin, Tex., another in Dallas, and one in Chicago. They are used for everything from reviewing new Web page designs to celebrating the close of a big deal with a (now crystal-clear) ring around a tabletop gong.

Industrywide, video manufacturers shipped 164,000 whole-room systems in 2006, up from 135,000 in 2005, according to Andrew D. Wainhouse of research firm Wainhouse. But that doesn't include the new telepresence systems, which in total shipped an estimated 250 units last year, according to IDC. The research firm estimates shipments will grow to 1,000 units in 2008.

The new systems have a see-it-to-believe-it quality that sharply separates them from older products. It's like the time you see a football game in HDTV on a 50-inch screen in a local consumer electronics store. "Wow!" exclaims Shigeru Ikeda, an NTT Communications executive, upon first seeing Cisco's three-screen setup. "This is intense." Ikeda popped into Cisco's New York office with some colleagues to talk about NTT becoming a telecom partner overseas.

For the massive data capacity that makes such quality possible, you can thank the telecom giants. Over the years they've built more efficient communications lines, bumping up the capacity to handle video as well as voice traffic while driving down the cost. And advances in high-def video displays have improved screen resolution to 10 times sharper than standard color.

The tech advances coincide with a sense among many high-

Blackstone
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Toshiba recommends Windows Vista™ Ultimate.



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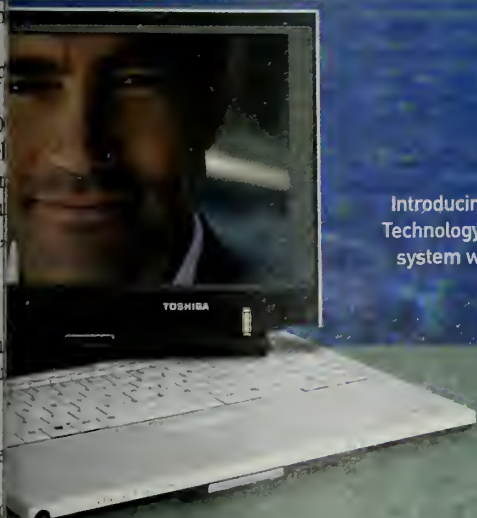
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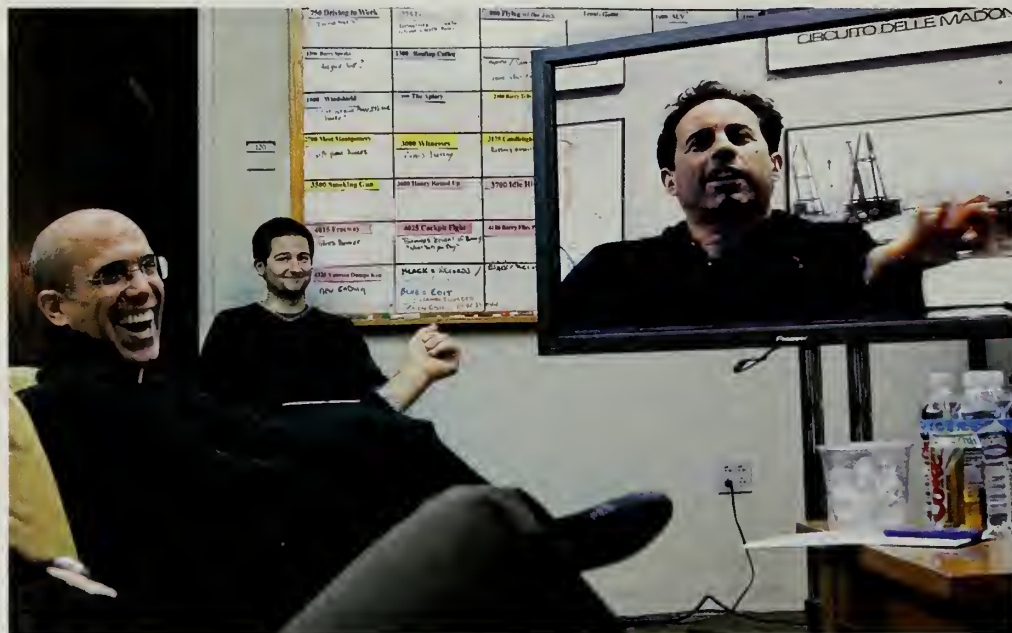
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powered business people that their travel schedules are reaching the breaking point. As companies grow ever more global, relationships become increasingly dispersed. Today, 91% of all employees don't work at their headquarters, according to Nemertes Research. Life on the road was already no picnic, but September 11 added to the stress.

It was such weariness that drove Jeffrey Katzenberg to think big about videoconferencing. The CEO of DreamWorks Animation SKG used to fly from Los Angeles to the company's offices in Bristol, England, once every three weeks. He would leave at 2 in the afternoon to arrive at 7:30 the next morning; work until 7:30 the following night; then take a 10-hour flight back home. Plus he was on a plane almost once a week to the company's Northern California unit. "The wear and tear on me, as well as the handful of people flying with me, was very, very hard," Katzenberg recalls.

CRYSTALLIZATION

IN THE FALL OF 2002, Katzenberg challenged his tech team to come up with a way to bring his creative people together virtually. Katzenberg, an experienced producer whose life is all about bringing characters to life on screen, pushed his team to create something that made the technology transparent and the experience nearly real. For help, CIO Ed Leonard went to HP, a longtime DreamWorks technology partner. HP completed the system in late 2005 and rolled it out as Halo last year.



The system that DreamWorks refers to as its B2B room mimics a typical boardroom, with a large conference table. Meeting participants sit on one side of the table, and their remote colleagues sit opposite them, behind a similar wood table reflected, mirror-like, on three giant flat-screen monitors. A fourth screen, situated above the other monitors, allows all participants to view the same drawings and storyboards as they talk through animated movie scenes.

A modified version of the system is on display one February day as Katzenberg and a creative crew work out some scenes with comic Jerry Seinfeld for an upcoming animated film, *Bee Movie*. Seinfeld has two large, black flat screens arranged in a "V" in his midtown Manhattan office. He sits in a black desk chair, a tan sofa behind him. Katzenberg sits on a couch in

PLAYBOOK: **BEST-PRACTICE IDEAS**

Secrets of A Glitch-Free Setup

ASK THE EXPERTS

Just like buying a home HD or buying an office video system requires research. Ask questions of experts at places like NASA's Jet Propulsion Lab, which specializes in telepresence-conferencing technology. Innovators such as Polycom

his Glendale (Calif.) office, facing a single screen. In a surreal way, it feels as if Seinfeld is in the same room.

In the movie, a bee (with Seinfeld's voice) leaves the hive and discovers, to his horror, that humans have been stealing his honey. In this session, Seinfeld freely suggests tweaks to the script, as if he's pushing paper across the table to Katzenberg and crew. "Can we do that thing with the truck?" he asks. "Just go back to that moment and let me see lines with the pictures," Seinfeld says. His right screen quickly morphs as someone in L.A. types the new language onto the screen. Almost instantly, the applicable storyboard is up on the left monitor. Both sides scroll back and forth without much fuss or confusion. "It's been phenomenal," Seinfeld says later. "I

wasn't going to move to L.A., so I don't think Jeffrey and I would have made the deal if this wasn't possible."

Such face-to-face encounters allow participants to discover meaning—the understanding of an idea, the crystallization of a concept—in ways that might not have been achievable otherwise. Consider a recent meeting at McKesson Corp., a major supplier of medical equipment and services. Two technicians in the San Francisco headquarters are faced with three others in the Atlanta area offices over a Cisco setup, discussing how to conduct a virtual trade show with vendors. About midway through, the CIO, Randall Spratt, walks in and takes a seat in San Francisco.

DREAMWORKS DIALOGUE Katzenberg and Seinfeld confer via video hookup

If the meeting were done over the phone, those on the other side would have had no idea their boss was in the room. But via video, the Atlantans sit up and lean forward upon seeing Spratt. He fires a string of questions at colleague Eri Sugar: "Aren't we telling vendors we don't need your sales people?" he asks. "Have you talked to vendors about this?" Sugar turns away from the CIO, looks directly at the monitor to address someone in Atlanta, and asks a question without having to mention whom he's talking to—it's clear to everyone in the room. The colleague in Atlanta responds and everyone nods in affirmation. "Great idea," Sugar says.

RE IS KEY

is a lot whether your relaxed and scorns om settings, or is more Collaborative cultures ed an extra screen to t or data.

DON'T SCRIMP ON VIDEO...

Video is only compelling when people look lifelike. Don't settle for less than high-definition resolution—at least a “720p” screen, which transmits a 1280-by-720-pixel frame 30 times per second.

...OR AUDIO

Look for systems that allow multiple conversations to occur simultaneously. Consider getting spatial audio, which lets sound come from different parts of the screen, depending on where a person is seated.

MAKE IT SIMPLE

Launching the videoconference should take no more than the press of a button. A technician should not have to be present.

Imagine how this exchange would go with herky-jerky video audio. “There would be pauses that stifle creativity,” Sugar. McKesson, which has tested Cisco’s system for several months, plans to add 7 to 12 rooms to its existing 2 this year. The company estimates it would spend \$1,100 to fly in the people, so just 2.5 trips per week pay for use of the video n for that week. Says Spratt: “To a person, we would rather this than travel.”

Still, is there any evidence that videoconferencing—not ter how realistic—will put a real dent in business trips? Not yet. At their current prices, presence systems are being used mainly by large corporations and big-time executives, who, as Lee Doyle, IDC’s vice-president of networking, puts it, get “sick of being on the plane.” But overall demand for corporate travel remains robust, according to American Express Co.’s Business Travel Div. In fact, a survey taken at the end of 2006 by the National Business Travel Assn. found that 68% of corporate travel managers expect their companies to take more trips this year than last.

What could change. With fuel and other expenses rising, the cost of the average business trip—including airfare, car rental, hotel—is expected to climb nearly 5% in 2007. Analysts say the price of new video systems should drop by 10% to 15% over the year.

As technology costs come down, organizations also may find it easier to adapt it to their distinct cultures. Not everyone wants a full-blown conference room setup. Consider HOUSE

Productions & Casting, a New York outfit that organizes and conducts auditions for movies, TV shows, and commercials. A boardroom setting would make these artists’ skin crawl. So in their loft-like offices on the lower West Side of Manhattan, they’ve installed a system by LifeSize Communications with a single high-def, 50-in. screen used to view participants auditioning from West Hollywood, Calif. Says Adam Joseph, HOUSE’s creative and casting director: “We’re the chill, relaxed videoconferencing place.”

At Cisco, CEO John T. Chambers imagines a day when high-quality video technology is so affordable that households will connect to each other via videoconferences simply to “hang out,” one living room connected to another. It’s back to the ’64 World’s Fair, but with broadband and high-def TV. But why stop there? In a move that invokes Marshall McLuhan’s global village, Cisco announced in January that it is donating complete systems to the governments of five nations: Egypt, Jordan, Lebanon, Turkey,

and the United Arab Emirates. The idea is to improve communications and collaboration among those countries by harnessing the capabilities of high-quality video.

In a world fraught with political and cultural tensions, video presents an opportunity to at least begin discussions, says Temple University’s Lombard. “Here’s an opportunity for [people] to meet on an equal basis and do it more regularly,” he says. “It’s not going to make people get along, but it allows them not to be isolated.” ■

—With Megan Tucker in New York

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we would
rather use this
than travel”*

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Paul Pressler's Fall From the Gap

Hailed on his arrival, the former CEO is now viewed as "the wrong guy at the wrong time"

BY LOUISE LEE

WHEN PAUL S. Pressler arrived as the chief executive officer of Gap Inc. in the fall of 2002, he was exactly what the board wanted—or at least what it thought it wanted. The polished, good-looking Disney veteran was a hard-nosed operations wizard, not a dreamy fashion junkie. He seemed to be just the man to restore discipline to the floundering company. But over the next four years, Gap's performance came apart at the seams. On Jan. 22, Pressler resigned.

The immediate post-mortem analysis: He was a numbers guy who didn't appreciate the nuances of the fashion business. That's true, but it's only part of the story. Pressler's problems involved more than just a few bad bets on colors and styles. According to 12 former employees interviewed by *BusinessWeek*, he also bungled some of the very things that were supposed to be his strengths, including cost-cutting campaigns, human resources initiatives, and supply chain streamlining efforts. One ex-employee characterizes Pressler's tenure as "total system failure."

Pressler's management shortcomings were particularly visible at the company's most important division: its flagship Gap brand. The story of his failed effort to fix this once-proud chain, insiders say, is a classic demonstration of what can happen when a talented man is handed the wrong mission. "He is a skilled leader and he understands how to build a team, but unfortunately he didn't build a team for the particular challenges Gap faced,"

says a former insider. "Maybe he was the wrong guy at the wrong time."

Gap wouldn't comment for this article. "We've said what we have to say on Paul's departure and are moving on with the business," said company spokesman Greg Rossiter. At the time Pressler left, board Chairman Robert J. Fisher said that the company "improved its operations, strengthened its balance sheet, greatly enhanced its online presence... and improved its standing as a global corporate citizen" under the ex-CEO's leadership. Pressler didn't respond to repeated requests for comment, including a list of written questions.

In the wake of Pressler's departure, Gap is still reeling. Companywide, sales at stores open at least a year fell 7% in the most recent fiscal fourth quarter, which ended Feb. 3. Full-company earnings for 2006 are expected to decline 33%, to \$739.8 million. Although shares ran up significantly following Pressler's arrival, increasing from about \$10 a share in the fall of 2002 to more than \$24 during the summer of 2004, they have traded in the \$17-to-\$20 range ever since. Now frustrated investors are waiting for a big strategy pronouncement the Gap has promised to deliver on Mar.

One former worker calls Pressler's tenure "total system failure"

1. Some hope the board of directors will put the entire company up for sale.

That's a steep fall for a retailer that, just a decade ago, seemed perfectly attuned to American tastes. When the workplace went casual in the 1990s, Gap was at the ready with big selections of khaki pants. When fleece vests were popular a few years later, Gap had them in a rainbow of colors. Everyone seemed to own a classic Gap pocket T-shirt or two. Yet the brand,



NEATLY PRESSED
Pressler came across as likable and approachable

EVAN KAFKA



always a symbol of affordable style, also appealed to fashionistas. Actress Sharon Stone wore a black Gap mock turtleneck to the 1996 Oscars. Supermodels donned white Gap jeans and shirts on the cover of *Vogue* magazine in 1991.

Between 1989 and 2001, companywide sales rocketed from \$1.6 billion to \$13.7 billion. Those stunning results were driven in part by the breathtaking success of the Old Navy chain's inexpensive wares. At the same time the Banana Republic chain—which in 1989 shed its original safari theme in favor of a more sophisticated, urban aesthetic—also sizzled.

ALIENATING LONGTIME CUSTOMERS

BUT BY THE END of 2001, the Gap brand and Old Navy were suffering sharp growing pains. Under Millard S. “Mickey” Drexler, the company’s CEO at the time, the two chains overexpanded. Long-term debt ballooned from \$780 million to \$2 billion in 2001. Simultaneously, the usually trend-savvy Drexler oversaw a series of fashion missteps, in particular veering toward super-hip clothes that alienated longtime customers. Earnings sank, and in 2002, Drexler was pushed out.

Along came Pressler. A 15-year Walt Disney Co. veteran, he had risen to the chairmanship of the company’s amusement parks and resorts unit. By nature a methodical thinker, say people who worked under him at Disney, Pressler embraced market analyses and other research to help him understand consumer spending patterns. He also imposed strict cost controls that irked his creative staff. “At Disney, he never had to deal with the creative, qualitative side of design,” observes Steve Roukis, managing director at Matrix Asset Advisors, which holds about 2 million Gap shares.

Gap could not have been happier with its new leader. “Paul knows how to lead creative, customer-focused organizations,” said Gap founder Donald G. Fisher in a statement announcing Pressler’s hiring. Once at Gap, Pressler, who wore neat jeans, jackets, and a ready smile, came across as a likable and approachable manager. “Anyone who’s ever met Paul agrees he’s a nice guy,” says a former Gap insider.

So the honeymoon began. At the start, Pressler had the benefit of excellent timing: Clothing designed during Drexler’s final year on the job was starting to appear in stores and did well. Sales rose at the Gap brand, and companywide, for more than a year. Earnings shot up, too. Pressler went on a hiring spree, bringing in a handful of former Disney colleagues,

Paul Pressler's Fraying Fortunes



MAY 2004
Sarah Jessica Parker signs on as celebrity endorser, but her campaign fails to boost sales.



APRIL 2005
Cynthia Harriss promoted to lead Gap brand.

MAY 2006
Gap brand sales fall 8%, the steepest fall since early 2002.

SEPT. 2006
Gap launches disappointing Audrey Hepburn campaign promoting slim black pants.

2003

OCT. 2002
Paul Pressler hired as CEO.



MAY 2003
First-quarter sales at Gap brand rise 12%, the biggest rise in years.

2004



& Towne. Pressler assumes Muto's duties.

SEPT. 2004
Gary Muto leaves Gap brand to head startup Forth & Towne. Pressler assumes Muto's duties.

2005



SEPT. 2005
Gap launches the Favorite Jeans-Favorite Songs ad campaign, another disappointment.

2006



Fisher is named interim CEO.

JAN. 22, 2007
Pressler resigns, and Robert Fisher, chairman and son of founder Donald Fisher, is named interim CEO.

including Chief Financial Officer Byron H. Pollitt Jr., who paid down debt and restored the company's credit rating to investment-grade status. Pressler also hired another ex-Disney co-worker, Eva Sage-Gavin, to lead human resources.

It was Gap's longstanding corporate culture that caught Pressler's attention early on. At the time, the no-nonsense corporate mantra was "Own it, do it, get it done." But Pressler thought this ethos didn't sufficiently promote collaboration. He set out to promote a new environment built around the slogan "Purpose, Values, and Behaviors." Among the catchphrases were bromides such as: "Explore, Create, and Exceed Together." Pamphlets promoting communication and teamwork landed on employees' desks. Posters and banners trumpeting the bland new slogans went up around headquarters.

In the beginning, "people were very receptive" to the effort, says Alan J. Barocas, the company's former senior vice-president for real estate. "It was embraced." But eye-rolling started as the initiative began consuming a lot of time. Former employees say they had to sit through countless meetings, workshops, and role-playing seminars where Pressler and his HR executives discussed the new culture. Many staffers felt they were wasting their time in get-togethers that didn't address the crucial matter of creating and marketing clothes. "HR was

out of control," says a former insider.

Over the next couple of years, employees also felt bogged down in what they thought were unnecessary meetings with CFO Pollitt. With Pressler's blessing, Pollitt demanded highly detailed presentations that explained minutiae managers thought were far too detailed for a CFO, such as the margins on individual products or the costs of decorative trims. Confabs with Pollitt were "the antithesis of being creative and nimble. It was talking about the work vs. doing the work," says a former employee. Gap said that Pollitt declined to comment.

Despite Pressler's expertise and comfort with the operational side of the company, some of his initiatives in that area also backfired. In 2003, he kicked off a plan to remake the retailer's supply chain. One goal was to combine fabric purchases across all three of the company's brands, which had previously used separate suppliers. Pressler wanted to cut costs and speed the flow of merchandise from drawing board to store shelf.

But the effort stumbled. Since all three brands sell jeans made of denim, in late 2003 they began purchasing it together. But the big buying deals yielded denim of a single quality, weave, and weight. That meant all three brands were limited to one kind of fabric even though, with their different audiences, they needed to be able to offer an array of jeans. And with all that denim

ordered in advance, there was less incentive for designers to keep their eyes open so they could jump on the next great style. Jeans made with material from the pooled purchases ended up largely falling flat, and the joint purchasing effort was abandoned.

RAISING EYEBROWS

AS PART OF THE supply chain revamping, Pressler also tinkered with the way the Gap brand produced clothing samples. These prototypes had long been made at studios in Manhattan's Garment District. But Pressler moved sample making to Asia, where the company's many suppliers are located. With that change, designers had to create patterns, ship them to Asia, get the samples back, make changes, and ship them back to be remade. While making samples in Asia was cheaper than in New York, it delayed the process and "made you less nimble," says a former insider. Aggravating matters, the company instituted a new cost-cutting rule: No overnight shipping to Asia without high-level approval.

The summer of 2004 brought a pivotal change. Pressler reassigned Gap brand head Gary P. Muto to lead Forth & Towne, the new store aimed at women older than 35. While he searched to fill the hole at the top of the namesake division, Pressler led the Gap brand himself. The move raised eyebrows among employees, who worried about his lack of experience in apparel.

Their fears were confirmed. The Gap brand needed someone to referee when designers disagreed with the merchants

Frustrated employees complained that "HR was out of control"

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a common occurrence at retailers everywhere. Designers constantly push the limits toward edgier styles; merchants must make sure that whatever lands in their stores sells to the brand's mainstream audience. While Pressler encouraged designers and merchants to work together, "there was no tiebreaker.... He made it clear that he didn't want to be that person," says a former employee.

OFF-THE-MARK MARKET RESEARCH

EVEN MORE frustrating were Pressler's contributions during line reviews, where designers present clothing samples for a future season, and "store-set" meetings, where store-design staff show proposed merchandise displays. According to former employees, Pressler's suggestions were frequently phrased as questions. Typical of one: "Do you think it would be better to move the denim to the middle wall?" Afterwards, "meetings would end, and no one had a clue what he'd said," says one former insider. "We all had opinions, and it would be a bicker and a fight. All hell would break loose."

The first clothes produced under Pressler's leadership of the Gap brand started to reach shelves in the spring of 2005. But even supported by an advertising blitz fronted by actress Sarah Jessica Parker, the brand's sales fell 4% that spring and summer.

One sore spot was Pressler's directive to use the findings of the research staff, known as the consumer insights group, that he had created. Some designers and merchants didn't believe that the group's output—which included findings from consumer focus groups, polls, and surveys of customers and store employees—was particularly useful in the fashion business, because consumers aren't good at predicting what they'll buy in the future. "Paul didn't know how to interact with the design team, who didn't react to the science being imposed on them," says an ex-employee.

The constant disagreements delayed determining final designs. Ideas for any given season ping-ponged back and forth. Entire collections were made, and altered, and then reworked, sometimes several times over. With no decision-maker, "we'd go back and forth, and change, and redo, and then we'd be out of time" before orders had to be placed or stores would have empty shelves, says a former insider. In the 11th-hour crunch, staffers would end up falling back on lowest-common-denominator items, bland styles that they hoped would please everyone but risked pleasing no

one. Last August, for instance, Gap heavily promoted the good old safe T-shirt, hawking it as "the ultimate vehicle for self-expression." The campaign didn't reverse the brand's ongoing sales decline, which that fall clocked in at 7%.

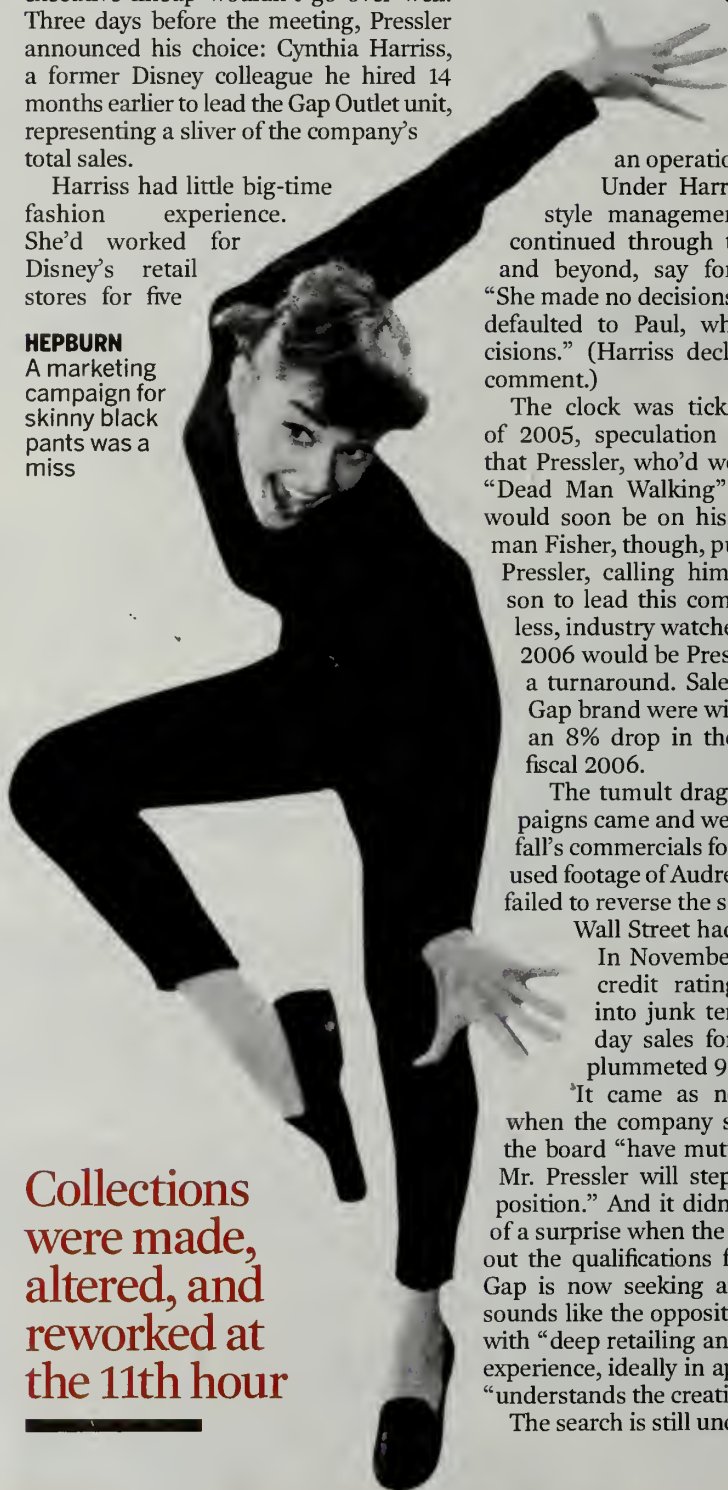
Meanwhile, the search for a Gap brand head was dragging on. Pressure to fill the job was mounting. A presentation to Wall Street analysts on Apr. 21, 2005, was fast approaching, and a gaping hole in the executive lineup wouldn't go over well. Three days before the meeting, Pressler announced his choice: Cynthia Harriss, a former Disney colleague he hired 14 months earlier to lead the Gap Outlet unit, representing a sliver of the company's total sales.

Harriss had little big-time fashion experience. She'd worked for Disney's retail stores for five

HEPBURN

A marketing campaign for skinny black pants was a miss

Collections were made, altered, and reworked at the 11th hour



years before moving to its resorts business in 1997. While she had worked for 19 years at Paul Harris Stores, a Midwestern apparel chain, its annual sales were well under \$1 billion, compared with the Gap brand's \$5 billion. Arun Daniel, senior consultant analyst at ING Investment Management, which holds about 1.3 million shares, considers the promotion of Pressler to be one of Pressler's critical

takes. "He needed a strong 2 in merchandising," Daniel. "Cynthia Harriss

an operations person."

Under Harriss, the Pressler's style management of the brand continued through the rest of 2005, and beyond, say former employees. "She made no decisions," says one. "I defaulted to Paul, who made no decisions." (Harriss declined request for comment.)

The clock was ticking. By the end of 2005, speculation was widespread that Pressler, who'd won the nickname "Dead Man Walking" on Wall Street, would soon be on his way out. Chairman Fisher, though, publicly supported Pressler, calling him "the right person to lead this company." Nonetheless, industry watchers predicted that 2006 would be Pressler's last show as a turnaround. Sales declines at the Gap brand were widening, reaching an 8% drop in the first quarter of fiscal 2006.

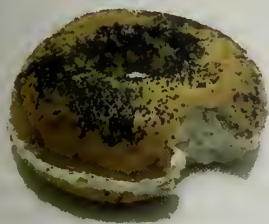
The tumult dragged on. Advertising campaigns came and went, including fall's commercials for black pants that used footage of Audrey Hepburn. They failed to reverse the sales declines.

Wall Street had come to expect

In November, the company's credit rating dropped below junk territory, and holiday sales for the Gap brand plummeted 9%.

"It came as no great surprise when the company said Pressler and the board 'have mutually agreed that Mr. Pressler will step down from his position.'" And it didn't come as much of a surprise when the company spelled out the qualifications for its next CEO. Gap is now seeking an executive who sounds like the opposite of Pressler, one with "deep retailing and merchandising experience, ideally in apparel," and who "understands the creative process."

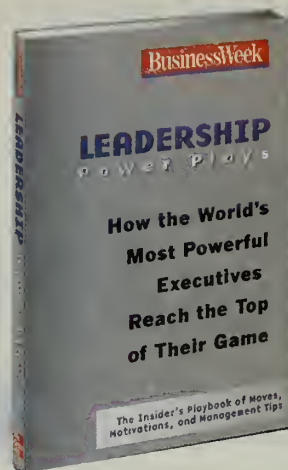
The search is still under way. ■



Hunger.



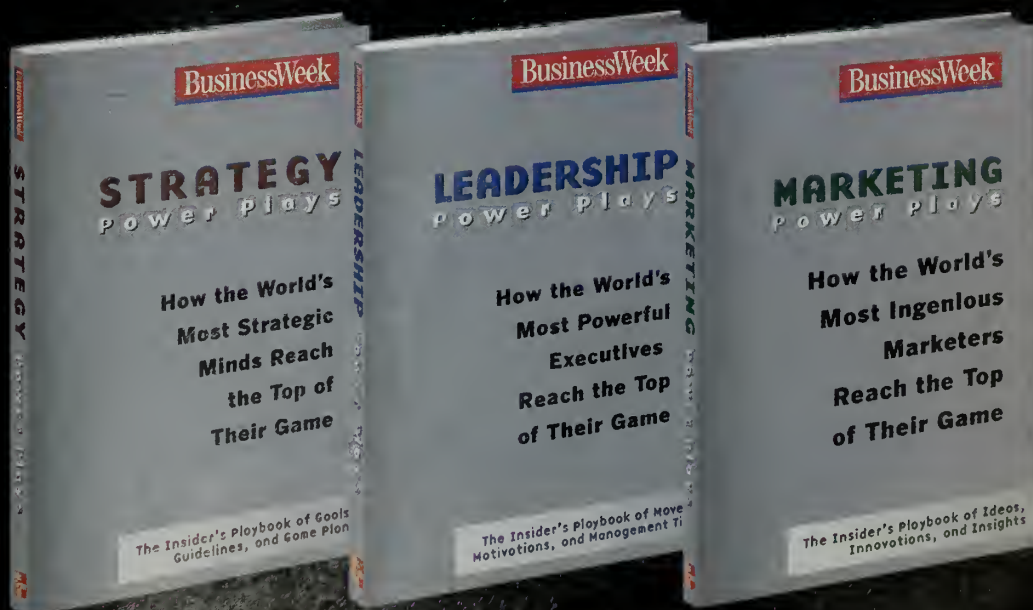
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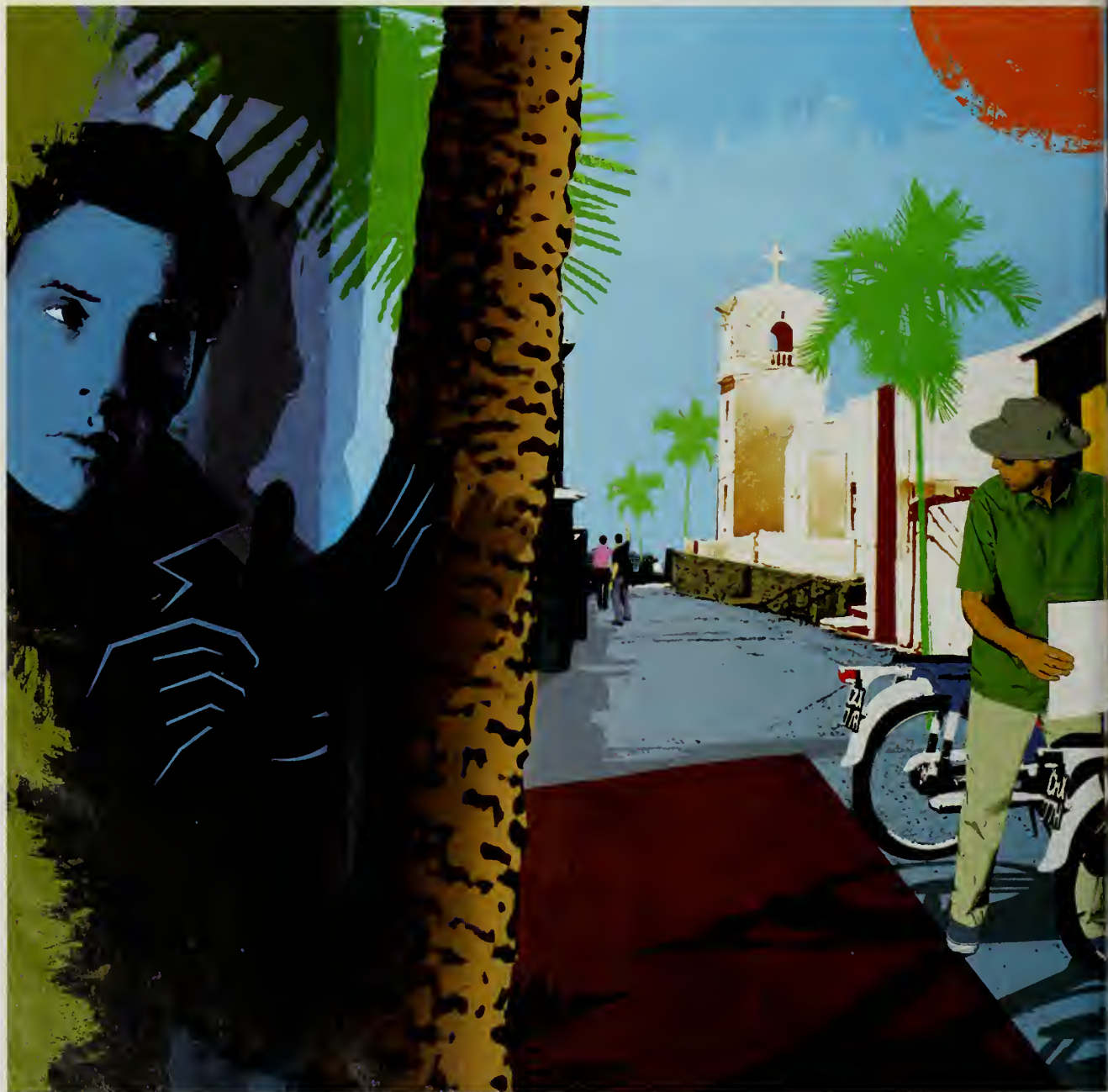
Spies, Lies & KPMG

An inside look at how the accounting giant was infiltrated by private intelligence firm Diligence

BY EAMON JAVERS

IN THE SPRING OF 2005, Enright, an accountant at KPMG Financial Advisory Services in Bermuda, got a call from a man identifying himself in a crisp British accent as Nick Hamilton. Enright said he needed to see Enright about matters of utmost importance.

Over the course of two meetings, Hamilton led Enright to believe he was a British intelligence officer, according to a person familiar with the encounters. Hamilton told Enright he wanted information on a KPMG project that Hamilton said



onal security implications for Britain. Enright, who was born in Britain, depositing confidential audit documents in plastic containers at drop-off points designated by Hamilton.

But Nick Hamilton was not an agent for Majesty's secret service, and the documents never found their way to the British government.

Nick Hamilton was in fact Nick Day, 38, a onetime British agent and co-founder of Diligence Inc., a Washington corporate intelligence firm that counts Wilbur Webster, former director of the CIA and FBI, among its advisory board mem-

bers. Diligence's client was not Britain's Queen, but Barbour Griffith & Rogers, one of the most formidable lobbying firms in Washington. Barbour Griffith represented a Russian conglomerate whose archrival, IPOC International Growth Fund Ltd., was being audited by KPMG's Bermuda office.

A 2006 scandal involving Hewlett-Packard Co. put the issue of corporate espionage in the headlines. Diligence's methods, revealed in court documents and interviews by *BusinessWeek*, show how far some in the corporate investigation business will go.

'PLAUSIBLE DENIABILITY'

WITHOUT DENYING this account of events in Bermuda, Diligence's Day says: "We've always respected the laws of the jurisdictions in which we operate." He adds that corporate intelligence firms like his provide an invaluable service. "We essentially help businesses deal with the risks of operating in challenging markets," Day says. "It's a role which government agencies don't necessarily have the resources or understanding to be able to fulfill."

From the start, Diligence's goal was clear, if far from simple: Infiltrate KPMG to obtain advance information about the audit of IPOC, an investment fund based in Bermuda. Russian conglomerate Alfa Group Consortium hired Barbour Griffith & Rogers through a subsidiary, and the lobbying firm in turn hired Diligence. Alfa is dueling with IPOC for a large stake in the Russian telecom company MegaFon. "We have a good chance of success on this project," Day wrote in an internal Diligence memo, referring to the Bermuda espionage effort. The memo, which *BusinessWeek* reviewed, added: "We are doing it in a way which gives plausible deniability, and therefore virtually no chance of discovery." Similar Diligence operations, the memo noted, had been successful before.

Within Diligence the KPMG campaign was dubbed Project Yucca, and it unfolded in stages, according to people familiar with the operation and documents filed in a court proceeding involving IPOC and Alfa in the British Virgin Islands. First, two Diligence employees contacted KPMG's Bermuda offices pretending to be organizers of a legal conference on the island, according to a person familiar with the operation. The Diligence staff members called KPMG secretaries and asked about how the office

worked. Soon, Diligence had the names of a handful of KPMG employees who might have access to the IPOC data. But Diligence wanted to narrow the list.

The intelligence firm was originally looking for people who fit one of two profiles for sources likely to leak the audit information, according to a Project Yucca planning memo. One personality type was a "male in his mid-20s who is somewhat bored...has a propensity to party hard, needs cash, enjoys risk, likes sports, likes women, is disrespectful of his managers, fiddles his expenses, but is patriotic." The memo described the second personality type as "a young female who is insecure, overweight, bitchy, not honest. Someone who spends money on her looks, clothes, gadgets. Has no boyfriend, and only superficial friends. Has a strong relationship with her mother." Apparently, no one on Diligence's list quite fit either profile, but the firm settled on Enright, the British-born accountant.

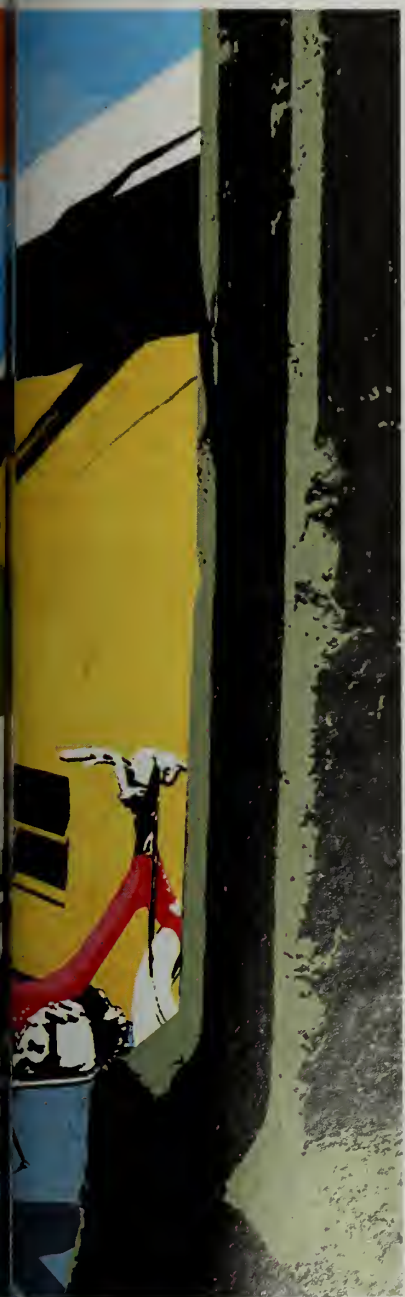
Enright soon got a call from Diligence's Nick Day, posing as Nick Hamilton, according to a person familiar with the situation. The two agreed to meet for lunch near the KPMG offices in Hamilton, Bermuda. At lunch, Day, who is dark-haired and has a warm smile, said the assignment he had in mind for Enright was top secret and involved Britain's national security. Day kept the conversation vague, never mentioning IPOC or the audit, according to the person familiar

with the situation. Day told the accountant he would have to undergo a British government background check to ensure that he was up to the task. Day produced an official-looking—but fake—questionnaire with a British government seal at the top and asked for information about Enright's parents, his professional background, any criminal history, and political activities, according to a copy of the questionnaire reviewed by *BusinessWeek*. Enright provided the information.

Several weeks later the two men met again, this time in a local bar, says the person familiar with the events. Day, still calling himself Nick Hamilton, told war stories from what he said were his days in the Royal Navy's Special Boat Service, Britain's equivalent of the U.S. Navy SEALs. He then steered the conversation toward his real interest: What did Enright know about the KPMG audit of IPOC?

Soon, Enright was handing over confi-

Diligence's goal: Obtain advance KPMG audit info on a client's rival



dential audit documents, including transcripts of interviews KPMG had conducted in the IPOC investigation, according to court documents on file in the British Virgin Islands and the source familiar with the events. Day picked out a rock in a field along Enright's 20-minute daily commute from his home in Elbow Beach and placed a plastic container under the rock, creating what spies call a dead drop site. At appointed times, Enright slipped new material into the container, which Day later retrieved. On one occasion, Enright left documents in the storage compartment of his moped, which he parked at his home. Enright had told Diligence employees where he hid the keys to the moped. When Enright left for a trip, Day collected the papers, according to the person familiar with the situation.

Day and Diligence took elaborate precautions to make sure Enright wasn't himself a plant or a corporate spy, people familiar with the events say. Diligence employees followed Enright from his office to every meeting with Day. A Diligence employee was at each meeting spot before the men arrived to determine whether Enright was using associates for surveillance. Enright was followed to his destinations when meetings ended. When Day left the meetings with Enright, the source says, the Diligence executive followed a process spies call dry cleaning, which was designed to detect whether Day was being followed. He walked a prescribed route through several narrow "choke points" that made it possible for Diligence employees to identify anyone who might have been tailing him.

MYSTERY WHISTLEBLOWER

DILIGENCE WAS PAID handsomely for its work. An invoice produced in a federal court proceeding in Washington involving IPOC and Diligence shows that Barbour Griffith was billed by Diligence "For Bermuda report and Germany work—A Telecom." Diligence was paid \$25,000 a month, plus \$10,000 a month for expenses, according to documents reviewed by *BusinessWeek* and an interview with a person familiar with the matter. The company was also paid a \$60,000 bonus for acquiring the first draft of KPMG's audit of IPOC. Diligence's total take couldn't be determined.

The undercover Project Yucca ended after someone—it remains unclear who—dropped a bundle of papers at the Montvale (N.J.) office of KPMG on Oct. 18, 2005. The papers included Diligence business records and e-mails with details of Project Yucca.

On Nov. 10, 2005, KPMG Financial Advisory Services sued Diligence for fraud and unjust enrichment in U.S. District

lobbying firm rented space at its Pennsylvania Avenue offices to Diligence. Edward MacMahon, a lawyer for Barbour Griffith says the firm has done nothing wrong and that no one affiliated with Barbour Griffith currently has an equity stake in Diligence. A person familiar with Diligence says the firm's shareholders are CEO Day, former U.S. Ambassador to Germany Richard Burt, Edward Mathias of Washington

Deep Connections

Diligence, which bills itself as an "intelligence gathering and risk management firm," has extensive political and business ties. The firm's Web site lists an advisory board that includes:



MICHAEL HOWARD

Former leader of Conservative Party in Britain



EDWARD MATHIAS

Managing director of private equity firm Carlyle Group



WILLIAM WEBSTER

Former director of the CIA and the FBI

Court in Washington. On June 20, 2006, the case settled. Diligence paid KPMG \$1.7 million, according to a person familiar with the settlement.

On June 15, 2006, IPOC sued both Diligence and Barbour Griffith & Rogers in the same District Court, alleging civil conspiracy, unjust enrichment, and other misdeeds. That case is pending. Gavin Houlgate, a spokesman for KPMG, declined comment, as did attorneys for KPMG at the New York law firm Hughes Hubbard & Reed. Kirill Babaev, a vice-president at Alfa's telecom arm in Moscow, said in a statement when asked about Alfa's involvement in the Diligence operation: "We are...not a party in any litigation with IPOC, and therefore cannot comment on any rumours or speculations in this regard."

Barbour Griffith & Rogers' most famous co-founder is Haley Barbour, who is now governor of Mississippi. Barbour left the lobbying firm in 2003, before the Diligence operation began. Another Barbour Griffith co-founder, Ed Rogers, was an early investor in Diligence. The

based private equity firm Carlyle Group, and Buenos Aires-based private equity firm Exxel Group. Burt confirms he is Diligence chairman but declines to discuss Project Yucca. Mathias confirms he is an investor in Diligence but says he is unaware of Bermuda events. Exxel Group lists Diligence among its portfolio companies on its corporate Web site but did not respond to an e-mail seeking comment.

It's unclear whether Diligence broke any British or American laws. In an interview at a Washington office, Day says his firm always stays within the law but have learned much since 2005. "As an organization we've changed a lot as a result of everything we've been through in the last year." He says Diligence has "spent a lot of time training our staff as to what they can and cannot do."

In a statement to *BusinessWeek*, IPOC director Mads Braemer-Jensen said: "The fact that Alfa hired Barbour Griffith & Rogers and Diligence use illegal and dishonest smear tactics against IPOC just shows that Alfa is trying to change the subject away from the fact that they stole from IPOC. We hope the U.S. and Bermuda law enforcement authorities will make note of this and take appropriate action against Alfa."

Guy Enright, who now works for Deloitte & Touche in London, declined repeated requests for comment on his relationship with Nick Day and his work on the IPOC audit. The terms of Enright's departure from KPMG couldn't be determined. But he apparently didn't come away empty-handed from his encounter with Nick Day.

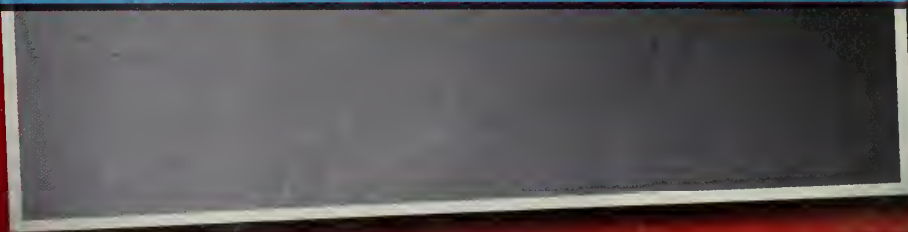
As Project Yucca wound down in 2005, Day, still in the guise of Nick Hamilton, gave Enright a Rolex watch worth thousands of dollars, according to two people familiar with the present. Enright would like to believe it was a thank-you gift from the British government, but it, too, came from Diligence. ■

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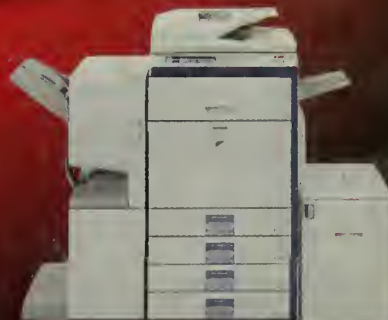


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Curiously Strong Teamwork

How Bill Perez and Bill Wrigley are confecting a winning partnership of outsider and heir

BY ADRIENNE CARTER

HAS BILL PEREZ LOST his mind? Just 13 months after succeeding Nike Inc. CEO and founder Phil Knight in late 2004, Perez found himself unceremoniously ousted from the top spot. Despite Knight's pledges to step back from the business, Perez was stymied by a hands-on boss and an insular culture. So what has he done to rebound? He's gone to work alongside another hands-on boss who pledges to cede control, at a company historically criticized for an insular culture.

The 59-year-old executive was named CEO of the Wm. Wrigley Jr. Co., the Chi-

cago-based candy maker, last October, less than a year after the Nike debacle. He succeeds Bill Wrigley, who is now executive chairman, to become the first outsider to run the company in its 116-year history. It is not a challenge either Perez or the 43-year-old Wrigley took lightly. There are few long-term stories of successful power-sharing at the top. But Perez came to the table with something most new CEOs don't have—the lessons learned from a failed relationship and a partner eager to make the new one work. He and Wrigley have taken steps to make sure that what happened at Nike doesn't happen again, stressing clear expectations, constant communication, and the need to present a united front.

Perez joins Wrigley at a point of strength. While Wrigley has struggled to turn around the Life Savers and Altoids brands it purchased in 2005 for \$1.5 billion, and global competition in its core gum business has heightened dramatically, the company's new focus on innovation has made it one of the brightest points in the industry. In 2006, it introduced 80 new products around the globe, including items such as Life Savers Gummies Fruit Splosions and Extra Professional Mints. After a long history of making few acquisitions and focusing entirely on gum, additions like the Altoids and Life Savers brands, and the purchase of A. Korkunov, the Godiva of Russia, are reshaping the company.

IN TANDEM
Executive Chairman Bill Wrigley and CEO Bill Perez

LONGTIME ADMIRERS

WHEN PEREZ GOT a call at his Racine (Wis.) home last August from Wrigley board member Melinda Rich to "feel him out" about a job, he was a bit mystified. After a 10-minute spiel on the company, Perez finally responded: "Mindy, I'm flattered that you guys would even consider me for the board, but I want to go back to work." When Rich clarified that they were considering Perez for the top spot, Perez was stunned: "I just froze, this

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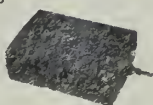


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ing: What happened to Bill Wrigley?"

What happened to Bill Wrigley, who became CEO in 1999 after the death of his father, William, was that he realized he needed to cede some power or risk not being able to handle the increased complexity of the business. Wrigley had known Perez for eight years. He served with him on the board of an industry council when Perez was the head of consumer goods maker S.C. Johnson & Son. There, Perez was CEO in a power-sharing arrangement with the company's fourth-generation leader and chairman, Sam Johnson, and then with Johnson's son, Fisk.

Over the years, Wrigley and Perez developed a bit of a mutual admiration society. They watched each other's career closely, dashing off notes after significant achievements. Perez sent Wrigley an e-mail in late 2002 after the company made a bid for Hershey Co. Even though the owners of the candymaker rejected the deal, Perez told Wrigley it was the right strategic move.

That personal history was a good foundation for a partnership. But before signing off, the pair and the board wanted to make sure they were all crystal clear on what a marriage of minds and energies would involve. This was a structure, after all, that simply wouldn't have been possible under Wrigley's father, who oversaw every decision, from the annual budget to the color of the carpeting at headquarters. At Wrigley's request, Duke Petrovich, the chief administrative officer, who has been at Wrigley since 1975, spent a day with Perez discussing Perez' management philosophy and getting a sense of how he would fit into the culture. Consulting firm Mercer Delta was brought in to run the pair through scenarios. The men met, first in Wrigley's suburban Chicago home and then in a hotel nearby, to make sure they had similar views and expectations for how the partnership would work: What would happen if they disagreed on an acquisition? Who would have the ultimate approval? To whom



MORE THAN GUM
Wrigley's Global Innovation Center in Chicago

should the senior executives report?

In addition to defining the partnership, Perez was sussing out how other

power-sharing duos made the arrangement work. He put in a call to Starbucks Chief Executive James L. Donald. What, he asked, was the secret to his success with Howard Schultz, founder and chairman of Starbucks Corp.? Much of Donald's answer had to do with making sure that information flowed easily and constantly between the two.

Bill W. and Bill P., as they're known internally, have taken that to heart. They send each other e-mails three to four times a day, meet for lunch frequently, and chat over the phone on the weekend, even if it's just to coordinate clothes for a photo shoot. Perez keeps a small notepad to jot down things he wants to discuss with Wrigley and ensures the list never gets longer than a page. It's a far cry from Perez' minimal communication with Knight at Nike: "I thought silence was a form of agreement," he says.

It's equally important, Wrigley's leaders say, to make sure they present a united front. That was something Perez learned at S.C. Johnson. If he and Johnson had an issue, they debated it privately so that they

appeared to be of one mind, and all disputes appeared to come from both sides. It was a dynamic that had been absent at Nike, where it wasn't clear who had the final say. At Wrigley, the Bills are going the S.C. Johnson way. For example, before a week-long meeting of the senior leadership team, Wrigley and Perez disagreed on a couple of points. Rather than debating in front of others, they spent two hours hashing out the issues before the meeting started at 9:30 a.m., and ultimately came to an agreement.

SURGING REVENUES

THE DUO'S "divide and conquer" strategy—Perez focuses largely on day-to-day operations and financials, while Wrigley spends much of his time on strategy, innovation, and culture—seems to be working. It's a fluid arrangement. If Perez is tied up at a customer meeting, Wrigley will jump in to check out, say, a manufacturing summit. Already, they've tag-teamed on major acquisitions like the recent \$300 million purchase of A. Korkunov, the chocolatier. While Wrigley was the point person on the deal, Perez weighed in on how to structure it. Under Perez' influence, the company decided to buy 80% of the business up front and 20% later, an arrangement that helps to prevent a sudden talent drain, since the owners are retaining a stake.

The market apparently thinks the pair are a good match. Shares jumped 13% the day Perez' hiring was announced—the biggest one-day gain in 20 years. The stock is up about 60% since early 2000, and revenues have grown from \$2 billion to nearly \$5 billion. The pair's continued successful collaboration will determine whether Wrigley moves to the next level. "You may want to have this structure in a company," says Wrigley. "But if you've got the wrong CEO or the wrong chairman, no matter what you do, it's not going to work." ■

—With Stanley Holmes in Secaucus, N.J.

PLAYBOOK BEST PRACTICE IDEAS

Power Sharing

Running a company with someone isn't easy. Here's how to do it gracefully:

SET CLEAR EXPECTATIONS

Define distinct roles. At Wrigley, Bill Perez handles the more operational and financial aspects of the business; Bill Wrigley focuses largely on innovation, long-term strategy, and culture.

OVERCOMMUNICATE

It's important to know what the other person is thinking so there are no surprises. Wrigley and Perez exchange e-mails three to four times a day, meet for lunch frequently, and chat over the phone on weekends.

BE OPEN TO COMPROMISE

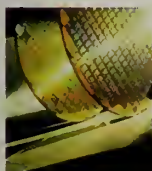
Power sharing works only if executives are willing to be flexible. Wrigley told Perez from the start that he should feel comfortable making changes, that "nothing is sacred."

SPEAK WITH ONE VOICE

It doesn't help the partnership if the pair clash in front of the team. If Wrigley and Perez disagree on an issue, they debate privately, ultimately presenting a united front to employees.



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Yahoo's Bid To Think Small

An initiative dubbed Brickhouse aims to give entrepreneurial employees room to run

BY CATHERINE HOLAHAN

IN SILICON VALLEY, BEING A BIG man on campus isn't always a bonus. Yahoo! Inc. has learned this the hard way. The 13,000-employee company has found itself struggling against small startups to build the best next-generation Web features, tools, and community sites. In a few key cases, such as software for sharing photos online, Yahoo developed its own product only to eventually spend tens of millions of dollars to acquire tiny competitors that had done a better job of attracting the young and digital.

Now, Yahoo is trying to tap its inner startup. On Feb. 7 the company released Pipes, a service that allows Yahoo users to combine, or "mash up," data from various Web sites (mixing news feeds from Google and Yahoo, for example). Even more ambitious is the initiative that gave birth to the idea. Pipes is the first product to come out of Brickhouse, a new division of Yahoo scheduled to launch officially around the beginning of March.

Brickhouse marks a dramatic break from Yahoo's usual way of doing things. Its 14,000-square-foot offices are located in the hip South of Market neighborhood in San Francisco, 40 miles away from Yahoo headquarters in strip-mall-laden Sunnyvale. The facility is bereft of Yahoo logos. Purple, the company's signature color, is noticeably absent. The staff is made up of employees with the kinds of ideas that, in theory at least, would have the venture capitalists of Sand Hill Road whipping out their checkbooks.

Teams are built around promising concepts. And the whole effort is led by a genuine star of the Web 2.0 movement, Caterina Fake, who co-founded the innovative photo-sharing site Flickr, which Yahoo acquired in March, 2005. "We've brought some bona fide rock stars into the group, of amazing talent and creativ-

ity," says Fake. "Brickhouse gives us the ability to capture all the cool, inventive ideas they've got and develop them."

Clearly, Yahoo would like to reclaim the reputation for Web innovation that Google Inc. has usurped in recent years. The search giant, known for giving employees one day a week to work on their

STAR POWER
Flickr co-founder Fake leads Yahoo's new in-house incubator



own projects, has seen its stock soar from \$85 at its initial offering in August, 2000 to more than 460 now. Yahoo shares, meanwhile, are roughly flat over the same period. Google's market cap has grown from \$23 billion at the IPO to \$144 billion, leaving Yahoo far behind at \$42 billion.

Outsiders question whether an incubator approach can turn that around. People who take jobs at a big company don't often have the big ideas—or the taking mentality—of an entrepreneur, says Todd Dagres, general partner of Boston venture firm Spark Capital. Financial considerations alone are a disincentive: If you develop an idea for Yahoo, Dagres points out, "you can't then sell it to Google for a billion dollars."

Brickhouse assumes that many Yahoo workers would develop great ideas if they weren't tied down by a day job. Bradley Horowitz, vice-president of product strategy, points to an experience stemming from Yahoo's Hack Day event last September, when employees and outsiders got a chance to tinker with the company's programs and develop new applications. One employee designed a tool that would leave behind users' fingerprints in the form of an image profile. Yahoo executives realized the program could be useful to Web publishers, bloggers, and others curious about who is visiting their pages. But the employee had another assignment, and there was no easy way to free him up.

In January, Yahoo purchased for an undisclosed price a company called MyBlogLog that does basically the same thing except it has extra features such as privacy functions that allow users to turn off the tracking.

Employee proposals will be vetted by Horowitz, Fake, and other executives. Horowitz says Pipes is a good example of the kind of transformative idea they're after. The technology was under wraps until bloggers, enlisted to test it, started buzzing about it. Yahoo was soon overwhelmed with interest. Now users are building search engines that pull in sites with bookmarks from the popular del.icio.us Web service, as well as feeds of *New York Times* photos and other things.

Brickhouse develops ideas whose success will receive additional compensation. Horowitz says the figure will be somewhere between a pat on the back and an acquisition-size bonus. "The idea is they would enjoy some upside," he says. ■



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Colleges: Too Close to Lenders?

Regulators are looking at how schools steer families to favored creditors

BY ANNE TERGESEN

CRAIG A. GREEN, DIRECTOR of financial aid at Westminster College in Salt Lake City, was incensed by a two-page ad that appeared in *The New York Times* on July 16. It accused schools of accepting cash and other benefits from lenders in return for throwing business their way. Since then, Green and dozens of other college financial aid officers have retaliated against the ad's sponsor, a small student loan company called MyRichUncle, by banning it from their conferences and, in Westminster's case, dropping it from their recommended lists. "They challenged our integrity," says Green.

Don't think this is just an intramural spat. If you have a child in college, the repercussions could have a big impact on his or her financial future. With the average price of a degree from a private college running \$125,000, families are loading up on debt. The vast majority look no further than the handful of names on preferred-lender lists colleges compile to help students pick from among thousands of loan providers. While students aren't required to choose a preferred lender, many financial aid offices encourage them to do so, partly to

ease their workloads. But shopping around could result in a better deal (table).

The controversy has helped propel student loans onto the radar screens of Congress and regulators. Senator Edward M. Kennedy (D-Mass.) is pushing a bill that would force schools to disclose gifts or benefits from lenders. The Education Dept. wants schools to list at least three lenders. And the New York Attorney General's office has requested information about preferred-lender lists from more than 60 colleges and 8 lenders, including Sallie Mae and Nelnet Inc., which say they're cooperating.

UNDER A CLOUD

MANY ARRANGEMENTS under scrutiny are tied to private loans. As the gap has widened between college costs and the \$5,500 a year maximum undergrads can borrow in federal students loans, private loans, which often charge about four percentage points more, have come to comprise 20% of total borrowings, up from 5% a decade ago. As the private market expands, some fear potentially



WESTMINSTER CAMPUS The college dropped MyRichUncle

conflict-ridden practices could spread.

Financial aid officers contend that MyRichUncle has blown problems out of proportion to help its efforts to market directly to consumers. MyRichUncle President Raza Khan insists he acted out of outrage: "We opened a lot of people's eyes."

Among the incentives under fire are payments some schools receive from lenders based on the amounts students borrow in the private market. While it's illegal for schools to make money from student federal loan applications, there are no such curbs on private loans. Education Finance Partners Inc., a private loan company in San Francisco, pays about 3% of schools a percentage—under 1%—of student borrowings. The percentage rises if students borrow more. Many schools list the company as a preferred lender, including Salve Regina University in Newport, R.I., Fordham University in New York City, and Lewis & Clark College in Portland, Ore., say they've used the firm for scholarships. The amounts involved range from \$3,600 for Lewis & Clark to \$26,000 for Salve Regina.

Look Beyond Preferred Lenders

To get the loan that's best for you, don't rely entirely on your school's lender list. Do your own research.

SHOP AROUND

To research lender discounts, look at such Web sites as FinAid.org. Some sites, including SimpleTuition.com, display only those lenders that pay to be listed.

COMPARE THE TERMS

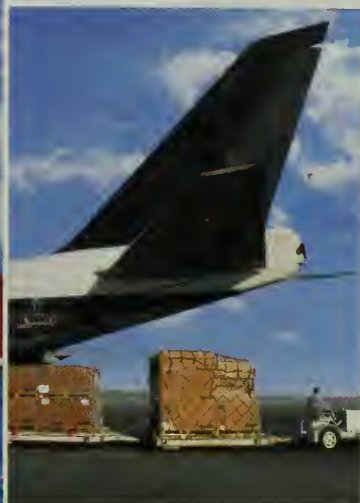
Most lenders waive origination fees on federally backed loans. Many offer discounts if you pay on time or make automatic payments. A few feature automatic rate reductions upon repayment.

CRUNCH THE NUMBERS

Use the calculators at Web sites like finaid.org to figure out which deal is best for you. To qualify for some deals, you'll have to meet certain criteria, such as a perfect record of on-time payments.

MAX OUT FEDERAL LOANS

You'll pay 6.8% for a government-backed Stafford loan, vs. about 12% for a private loan. With government loans, the amount you can borrow is capped.



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for Salve Regina, are too small to influence their decisions regarding lenders, the schools say.

Still, two of these schools have recently stopped the payments. Fordham, which received \$14,000 in one year, acted because of a "public perception that we are doing something inappropriate," says Angela Van Dekker, assistant vice-president for student financial services. After *BusinessWeek* contacted Lewis & Clark, it returned past payments and stopped future ones.

FAST TRACK

SCHOOLS ALSO BENEFIT from "opportunity" loans. In some cases, lenders set aside money so schools can direct private loans to students who would otherwise fail to qualify. Such perks can "be used as an incentive to encourage a school to put a lender first on a preferred list," says Mark Kantrowitz, publisher of FinAid.org. Joyce Hall, executive director of Purdue University's division of financial aid, says at Purdue such loans are too few—only 154 of 39,000 students have one—to "be a primary reason to select one lender over another."

Also on regulators' watch list are practices that discourage shopping around. Lasell College in Newton, Mass., asks families not to apply to any lender other than Citizens Bank, which handles 90% of Lasell's federal loans. Doing so "will delay the processing and delivery of funds," its Web site says. "We don't restrict students' choices," says Michele R. Kosboth, director of student financial planning.

Lasell uses an electronic system to certify loans from Citizens and paper for many others, which can lead to delays of up to a month.

Some schools even steer families away from certain lenders. Creda Camacho, director of financial aid at Montserrat College of Art in Beverly, Mass., told a MyRichUncle employee in a voice-mail on Nov. 30: "We do not work with MyRichUncle." Citing regulations that require schools to certify loans from a student's choice of lender, MyRichUncle appealed to college president Stan Trecker. "We initially erred in that response," Trecker told *BusinessWeek*. "We have made it clear to our financial aid staff that we need to be open to any lender." ■

Some schools have only one preferred lender

NASDAQ: From Predator to Prey?

After its failed LSE bid, those beaten shares may look cheap to investors—and rivals, too

BY JOSEPH WEBER AND MATTHEW GOLDSTEIN

EVER SINCE NASDAQ MADE its first aggressive move to buy the London Stock Exchange last spring, investors have punished its stock. Other major markets, including the New York Stock Exchange, are up more than 50% over the past year. But NASDAQ has sunk



Other deals could be on the horizon. CEO Robert Greifeld, who has bought two trading networks and three other businesses in his four years, has set sights on options, with NASDAQ's system set to launch by this fall. He plans to snare 20% of that exploding market by 2009 or 2010. To do so, Greifeld may need to expand his kingdom. Potential candidates: the scrappy International Securities Exchange as well as regional exchanges in Philadelphia and Boston.

Admittedly, the tech-heavy exchange faces plenty of minefields. For one, startups such as BATS Trading are biting chunks of NASDAQ's volume by undercutting its prices. NASDAQ's share of trading in its own listed companies has slipped to below 45% from 46.6% in December. Competition will only heat up with new regulations that force brokers to find the best price without preference for a market and with new entrants into equities trading, as the Chicago Board of Options Exchange. Already, the company has damaged its 2007 outlook.

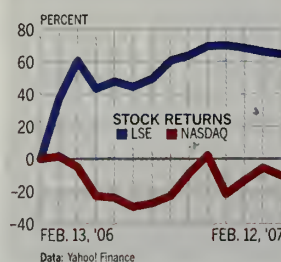
If NASDAQ can't drag itself up, the predator may be the prey. Its \$14 billion market value pales beside the Big Board's \$14 billion. For a place like Frankfurt's Deutsche Börse, NASDAQ would provide entrée to the U.S. and London. Private equity players may find appetizing despite regulatory hurdles. Current

Bay Area firms Silver Lake Partners and Hellman & Friedman own a total 24%. Both reiterated their support for Greifeld after the LSE deal fell through. So did financial-services consultant Larry Talbot. "Without the debt from the LSE acquisition, it might be an interesting play."

by 30% from its March high to 32, punctuated by a two-day, 16% plunge after its latest \$5.3 billion hostile bid for the London bourse collapsed on Feb. 10. So is the exchange a deal—either for individual investors or rivals?

Despite the LSE drama, NASDAQ turned in a decent year. Net income doubled, to \$127.9 million, on the back of strong trading growth and 94 new listings from other exchanges like NYSE defector E*Trade Financial Corp. It has also been paring the \$1.2 billion of debt used to finance its 29% LSE stake and other purchases.

A DOWNER DEAL





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The Next Wave

A Matchmaker For Inventors

UTEK is earning big bucks by pairing brainstormers with businesses

BY LOUIS LAVELLE

FOR GEORGE E. INGLETT, A researcher with the Agriculture Dept., the eureka moment came in 1995. Searching for a use for oat hulls, he shoveled a couple of pounds into a high-speed centrifuge in his lab in Peoria. What emerged was a white gel with no taste or calories. Adding it to food cut the fat and calories dramatically—Inglett managed to drop 50 pounds eating the stuff—but the gel had no impact on taste or texture. Inglett had discovered nutrition's Holy Grail: an all-natural fat substitute.

Inglett's discovery might have been for naught without an outfit called UTEK Corp., which ultimately found a small company to commercialize his product: ZTrim in Mundelein, Ill. UTEK, a technology matchmaker with an unusual business model, gives researchers like Inglett an outlet for their ideas, and it gives companies like ZTrim a way to outsource innovation by providing access to a database of more than 35,000 discoveries that would otherwise go unnoticed. "To have a robust product pipeline, you have to spend an inordinate amount of capital," says Clifford M. Gross, CEO of Tampa-based UTEK. "There are very few companies that can do that."

For university and government researchers struggling to license their discoveries, UTEK can make all the difference. Many universities have technology-transfer offices that are understaffed and underfunded. And many risk-averse companies are unwilling to take a flyer

on an interesting idea with uncertain commercial potential. The result: Only about 30% of the 18,000 discoveries made by university and government researchers each year ever see the light of day as commercial products.

North Carolina A&T State University's experience is instructive. When a researcher there stumbled upon a way to

It can be a costly road from the lab to the plant



detect microscopic cracks in an airplane fuselage, the discovery, while promising, turned out to be nearly impossible to sell. The technology-transfer office spent two years scouring North America and Europe for a buyer. Many companies wanted to see a prototype—typically a more than \$200,000 investment—and others simply weren't interested.

Then UTEK showed up, with Material Technologies Inc. in tow. Material Technologies, which specializes in monitoring metal fatigue, was interested in commercializing the technology, but its intent was to check the structural integ-

rity of bridges and highway overpasses, not planes. In August the three parties struck a deal. "We had no entry into the market," says M. Douglas Speight, school's director of outreach and technology transfer. "That's what UTEK brings to schools like ours."

A SHARE OF THE ACTION

UNLIKE OTHER TECHNOLOGY-transfer companies, which license technology they've acquired or charge fees to brokering deals, UTEK pays the research lab the licensing rights to its discovery. It then sells those rights to the client company for shares of stock, which UTEK agrees to hold for one year. UTEK might pay \$500,000 for the discovery and receive stock worth \$2.5 million. A lot can happen in a year—UTEK's stake in ZTrim, for example, ballooned to \$6 million.

SLIM LUNCH
Food made with ZTrim is low in fat and calories

the other hand, in dozen deals since the company's inception in 1997, the client company ceased operations, and UTEK's stake evaporated.

But UTEK has had more hits than misses, including deals involving technologies for fertilizer production, pollution monitoring, even land mine detection. Since 2000, the number of technology-transfer deals UTEK has brokered has quadrupled, despite robust competition, which includes publicly traded technology-transfer companies like UTEK, which went public in 2000, now holds equity stakes in 55 companies, for

portfolio valued at \$60 million. And each year it adds several thousand discoveries to its database. Through the third quarter of 2006, it had operating income of \$17 million on \$48.5 million in revenue, up from \$3.9 million in operating income and \$15.5 million in revenue for the same period in 2005.

One reason UTEK has a following among universities is that, in addition to a cash payment, its deals also guarantee a stream of royalties for the institution. Most direct a third of the royalties back to the individual researchers, which makes for a lot of happy inventors. ■

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The Power of the Pipeline

Bristol-Myers Squibb is beset with troubles, but its new-drug potential makes it a target

ARLENE WEINTRAUB

IN HIS DECADE IN THE RESEARCH trenches at Bristol-Myers Squibb Co., Dr. Elliott Sigal has seen more than his share of turmoil. After Bristol's chief scientific officer died unexpectedly in 2004 at age 51, Sigal was named his successor. When Chief Executive Peter R. Dolan, in September, lost his job over a bad deal with a company that wants to sell a generic version of Bristol's hit clotting drug Plavix. Now Bristol is searching for a CEO and fighting a patent case with the generic drugmaker. Sigal cuts out the noise by focusing on the work he started as part of Bristol's R&D leadership team in the late 1990s, when the company was suffering through a year-long drought of new product launches. "We had to uncork a passion for drug making," he recalls.

IF, BUT WHEN

IF UNCORKING HAS gone so well, it may have turned Bristol into a hot takeover target. As interim CEO James Cornelius tries to steady Bristol's shaky finances—the New York drugmaker just recorded its first quarterly loss since 1995—the one part of the company he's barely touching is Sigal's. Sigal has launched eight new drugs since he became head of development in 2002, has three cancer drugs in late-stage development and has more than a dozen compounds in its pipeline to treat diseases ranging from diabetes to depression. With many growth-starved Big Pharma companies desperate for new potential blockbusters, and a verdict due in the Plavix trial, a Bristol acquisition predicts Morgan Stanley analyst Michael Rubin, "is not a question of if. It's a question of when."

Bristol will not comment on the merger speculation, nor will one of the widely mentioned names, Plavix co-marketer



Sanofi-Aventis. Cornelius says that he is developing a plan he believes will increase Bristol's chances of surviving as an independent company, but that if an offer comes in "we have a fiduciary responsibility to consider any deal." Meanwhile, the board is interviewing CEO prospects, and Sigal has emerged as one of three internal candidates. "He has built a tremendous machine in research," Cornelius says.

Sigal has turned around Bristol's unproductive research labs using a combination of hard and soft incentives. He has fine-tuned a compensation plan that ties scientists' bonuses to the drugs they discover, awarding the highest premiums to the compounds that reach late-stage clinical trials. Sigal keeps his troops motivated by introducing them to patients who have been treated with Bristol's drugs, most recently bringing in a cancer patient who has benefited from Bristol's new product, Sprycel. "It makes scientists appreciate what they're doing," says Dr. Peter S. Ringrose, Bristol's former chief scientific officer, who retired in 2002. "The end point is the patient. Elliott has been quite good at communicating that."

Another way Sigal has managed to pump up Bristol's pipeline is through what he calls the globalization of the research process. While developing Sprycel,

for example, the company recruited 911 trial patients in 33 countries. Because the drug treats a rare form of leukemia, it would have taken several months to find enough patients just in the U.S. "The globalized approach allows us to enroll clinical trials faster, and time is money," Sigal says. Bristol coordinated the trial with 13 research hubs around the world that had previously operated independently. They were linked up electronically so that they could analyze data 24 hours a day. Bristol filed for FDA approval just two years after the first trial patient was treated—a process that normally takes six years.

Bristol has also become more selective in choosing its partners, seeking deals that will fill holes in its strategy of developing drugs to address large, unmet medical needs without stretching its resources too thin. In January Bristol structured a smart deal with London-based drug giant AstraZeneca PLC to develop two diabetes drugs. In

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Managing Big Pharma

Bristol's Appeal

Despite ongoing legal issues plaguing its hit drug Plavix, Bristol has emerged as a top takeover target in pharma. Here's why.

RICH PIPELINE Bristol has 13 drugs in early clinical trials and could apply for FDA approval in the next 15 months for three cancer products.

DIABETES WINDFALL A recent partnership with AstraZeneca to develop two diabetes drugs could net Bristol \$1 billion, even if the company changes hands.

COST SAVINGS A buyer could cut Bristol's \$12 billion in yearly expenses by as much as 30% via sales and research synergies, analysts estimate.

Data: Company and analyst reports



return for a 50% cut of the commercial profits, AstraZeneca is footing 75% of the development costs and half of the launch expenses. And Bristol, which recently slashed its primary-care sales force, will be able to share AstraZeneca's massive sales force. The deal does not include a "change of control" provision, meaning that any Bristol acquirer will get the same perks.

TRIMMING THE FAT

WHILE SIGAL IS plowing ahead with the strategy that has transformed Bristol's research and development productivity, interim CEO Cornelius must contend with more immediate concerns. When he was rushed into the top job last September, Bristol had already implemented a plan called WorkRight, aimed at cutting \$100 million in costs in 2006 and \$500 million this year. Cornelius believes that he can weed out an additional \$1 billion or so, and he's now developing what he informally calls WorkRight 2. The first phase of the program was about cutting the fat; Bristol has reduced the types of pens that it orders for its staff from 700 to 32, for example. For the second phase, Cornelius is considering more drastic measures, such as closing some of Bristol's 28 manufacturing plants. "There are no sacred cows," he says.

Investors and potential acquirers will

be watching closely for the verdict in Plavix patent trial. Bristol is expected to prevail and regain its exclusive hold on the market until 2011. But the damage has already been done: Bristol's general manager, Weston (Ont.)-based Apotex Inc., flooded distribution channels with its own version of Plavix before a judge ordered it to stop selling the drug last August. Bristol decided

to go ahead and market Plavix as if nothing had happened and instructed its salespeople to focus on the merits of its anti-clotting drug and not talk about the patent fight. Bristol's sales team did just that. Perhaps they did a little too well: Sales of both versions of the drug jumped 14% in each of the last two quarters, with much of the new business going to Apotex. Bristol lost more than \$700 million in Plavix sales

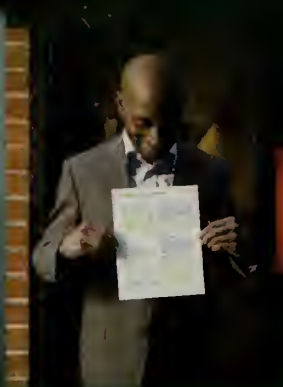
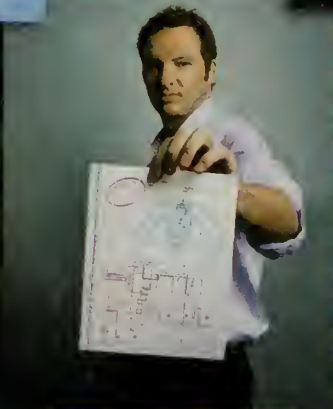
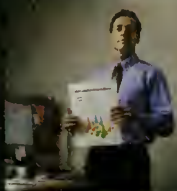
in the last quarter alone. And the company now faces a criminal investigation into how it handled the Apotex deal.

The Plavix debacle only underscored the urgency of Sigal's quest to generate a variety of new drug candidates that will mitigate the risk of future patent losses. "Good business will follow good medicine," says the scientist. But the struggling pharmaceutical industry's good business that is mixed with legal woes could translate into a loss of independence for Bristol. ■



CORNELIUS "There are no sacred cows"

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Sleek. Stylish. Samsonite?

The brand has been kicked around for years. Now Marcello Bottoli wants to take it upscale

BY SUSAN BERFIELD

MARCELLO BOTTOLI had a gilded career as the chief executive of Louis Vuitton when, three years ago, he left to run Samsonite Corp. It was a move from one of the world's great luxury brands to a company that had been mistreated by its private investors, was still recovering from a sharp drop in business after September 11, and had, in fact, come dangerously close to declaring bankruptcy for the second time in a decade. Bottoli, cosmopolitan, disciplined, and an alumnus of Procter & Gamble Co., described Samsonite as a sleeping beauty.

The same could be said of many once-troubled brands: Coach, Burberry, Cadillac—all had great legacies but lost their relevance over time. And Bottoli's plan is obvious; even he says so. He wants Samsonite to find its place in the expanding world of accessible luxury.

Since it was founded by Jesse Shwayder almost 100 years ago in Denver, Samsonite has been a near-complete reflection of the best and worst inclinations of the business world. Run by the Shwayder family until the 1970s, the company then had a series of owners who embodied the financial temperament of the times. Samsonite went through a leveraged buyout and was burdened by debt; it was taken over by private-equity investors and forced to survive on limited cash; it's been put into bankruptcy, gone public, and been delisted. Now Samsonite is in the hands of new private-equity investors (Ares Management, Bain Capital, and the Ontario Teachers' Pension Plan) who brought in Bottoli and

gave him a piece of the business (management owns 10% of the company).

As much as Samsonite seems so iconically American, it is also surprisingly global. By the late 1990s, Samsonite's image in America was no better than, say, Chevy's (the luggage was, some former employees recall with dismay, even sold in Wal-Mart). But in Europe it was always considered a premier brand, and the business success it experienced there may well have saved the company



BAGGING A STAR Alexander McQueen is designing for Samsonite now

during its darkest days. Sixty percent of Samsonite's billion or so dollars in sales are outside the U.S. Partly because of that, Bottoli has established the executive office in London, where 12 nationalities will be represented among the 50 people working there. The owners, ready to cash out, want to take the company public again, perhaps this spring. This time, though, they would like Samsonite to be traded on the London Stock Exchange. That would make it among the first U.S. companies to have its primary listing outside the country. "But," says Bottoli, "we stick to what we are proud of our American heritage."

Bottoli, who is 45, also hopes to give Samsonite a modern sensibility and fashion edge. To that end, he has brought in designers such as Alexander McQueen, the haute couture celebrity, to create signature lines of Black Label luggage. Bottoli hired the company's first creative director, who has gone back to the archives to create a vintage collection. The company is starting to sell leather shoes (they've been available in Italy for years), wallets, and stationery. Bottoli doubled the amount Samsonite spent on marketing and persuaded veteran traveler and showman Richard Branson to appear on the company's behalf. Coming up with this approach, Bottoli serves, was hardly rocket science. "Louis Vuitton does it every day," he says.

SIMPLE SOLUTION

BOTTOLI'S plan may be familiar, but it also has the advantage of being popular with employees (as well as most brand experts). Bottoli, like many chief executives brought into companies beset by problems, had to determine how to roughly upend the status quo, if included. Not very, he decided. "I want some people to shake things up," he says. "But I want the right balance of old and new." Frank Steed, a former president of Samsonite USA and now a licensee for the company, says: "People there are trying to move along as fast as Marcello wants. Sales for the first nine months of 2007 were \$784.4 million, 9.3% higher than the previous year's.

Indeed, Samsonite is doing well enough that the owners were treating him to a bonus in December. The board of directors approved a \$175 million stock distribution, paid for in part by taking on more debt. ■

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ONLINE: To see a video report on some innovative trends in luggage, including by Samsonite, go to www.businessweek.com/go/tv/luggage.

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Focus on Frames

Glasses are no longer for vision correction alone. There are some new eye-catching options.

MARISA FOX

From the sassy red glasses of *Ugly Betty* (the hit TV show) fame to the Fendi frames Jack Nicholson sports, eyewear has grabbed spotlight. Whereas a single pair sufficed, many people now have wardrobes of glasses they can rotate between the boardroom, bedroom, and the ballroom.

UBERNERD Thick, black angular frames define geek chic 95, "Dismembered," Chrome Arts, osainternational.com).

AVIATORS These glasses are sporty, sleek, and feather light, and they snap back into shape if you sit them (\$385, "rudi v.," ic! Berlin, berlin.de).

TECH SPECS Architectural spectacles that are made of titanium and acetate alloy, they graph a polish that's perfect for lining (\$370, Eyebeam 2, Kata, eyewear.com).

OFFICE STYLE Candice Bergen wears these half-rim readers on *Boston Legal* (\$85, "Cindy," Amy Sacks, amysacks.com).

FUNKY Red frames are the new red, thanks to *Ugly Betty*. But this angular style is more modern than the vintage cat's-eye frame worn on the show (\$495, A0464, Mikli, mikli.com).

EVENING LIMELIGHT Intricate pieces with hand-painted designs or inlaid crystals sparkle at night. The designs on this laser-cut, metal-studded frame are inspired by Taj Mahal (\$700, JL 1556, Judith Leiber, judithleiber.com). ■

For him



For her

BusinessWeek weekend

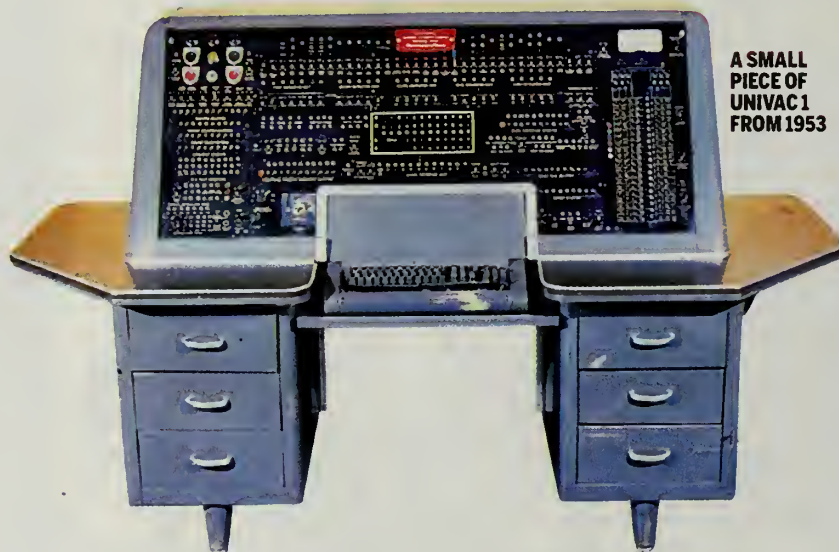
TELEVISION: To see the latest fashionable frames, watch our weekly TV show, *BusinessWeek Weekend*. Check local listings or go to businessweekweekend.com.

Where PCs Were Born

Albuquerque—yep, Albuquerque—is where it all began. A new exhibit goes all the way back to show how far we've come. **BY JAY GREENE**

IT SITS ON A desk, mysterious and mute, a relic from a bygone era. The UNIVAC 1 console is just 54 years old, but in techno-time, that's an eternity. This remnant of the first commercial computer, which in its entirety would fill a single-car garage, is just one of the objects preserved for posterity in *STARTUP: Albuquerque & the Personal Computer Revolution*, a new 4,000-square-foot permanent exhibit at the **New Mexico Museum of Natural History & Science**.

Why Albuquerque? That's where *STARTUP*'s biggest benefactor, Paul



**A SMALL
PIECE OF
UNIVAC 1
FROM 1953**

but *STARTUP* reminds us that it's where an important piece of its history began. Says Allen: "It takes me back."

YOU CAN'T GO TO Albuquerque and not eat Southwestern food. Two of the area's best restaurants are virtually a sandstone throw from the museum. **Ambrosia Cafe & Wine Bar** at 108 Rio Grande Blvd. NW in Albuquerque's quaint Old Town puts a modern spin on the classics, including duck mole-brained duck enchiladas with cranberry pear chutney and queso fresco. A popular local lunch place is **Duran Central Pharmacy** at 1815 Central Ave. NW. The cash-only counter in the back offers a winning green chili stew and homemade tortillas. If you can bear the wait, the food is phenomenal. ■

Telemetry Systems, better known as MITS. It was the MITS Altair 8800, which Allen read about in the January, 1975, issue of *Popular Electronics*, that inspired him. (The machine and an original copy of the magazine are both in the museum.) Before Microsoft, Allen was a programmer at Honeywell in Waltham, Mass., and Gates was an undergrad at Harvard. (He famously dropped out.) Two years after Roberts sold MITS in 1977, Allen and Gates moved Microsoft to Seattle, their hometown.

The exhibit includes a video detailing the history of PCs as well as *Spacewar!*, one of the earliest computer games,

which was developed at Massachusetts Institute of

Technology in the 1960s. But the best displays are the ancient machines that launched the computer era.

One highlight is the Traf-O-Data computer Allen and Gates built in high school for their first venture. It measured traffic flow and recorded the data on punched tape. "It was hellacious to get that thing working," Allen recalls. "I guess it convinced Bill and me not to get into the hardware business."

The museum has a strong Microsoft presence, but Apple and IBM get their due. You can see a Steve Wozniak-designed Apple 1, circa 1976, one of only 200 sold. Also

on display: a copy of the 1931 edition of *Songs of the IBM*, a company collection of tunes that includes such toe-tappers as *March on with IBM*. There are separate nods to Linux creator Linus Torvalds, free-software champion Richard Stallman, and Microsoft's current nemesis, Google.

Albuquerque seems light-years away from the computer industry,



ALLEN AND GATES IN 1981

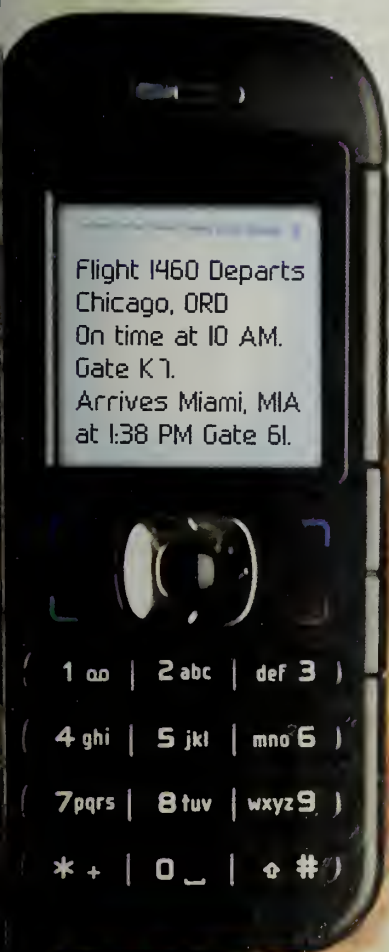
Allen, and fellow geek Bill Gates launched Microsoft in 1975. They chose the city to be close to their first partner, Ed Roberts, who ran Micro Instrumentation &



ALBUQUERQUE'S OLD TOWN



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BY ROBERT PARKER

Carlisle's Mighty Cache of Reds

SOFTWARE DEVELOPER MIKE OFFICER made wine at home just for his own enjoyment, and he found it more compelling than writing code. In 1998 he and his wife, Kendall, launched Carlisle Winery & Vineyards in Sonoma's Russian River Valley, starting with old-vine zinfandel. **J** The winery is sold out of the 2004s, but an online search will yield merchants who have it. Officer can help find the wines if you contact him at carlislewinery.com. That's also the place to get on the list for the 2005s that will be released this year.

Russian River Valley Carlisle Vineyard Zinfandel 2004

93 points. From the proprietor's own vineyard, this cuvée is primarily zinfandel with small amounts of petite sirah, Alicante Bouschet, and other little-known black varieties mixed in. The wine is loaded with aromas of raspberries, pepper, spice, and a hint of cherry liqueur. \$38

Tom Feeney Ranch Zinfandel 2004

94 points. This fabulous vineyard, among the younger ones in Carlisle's portfolio, makes one of the larger-production wines. It has a dense ruby/purple hue, fabulous balance, and oodles of briary blackberry fruit intermixed with lavender, vanillin, and spice box. \$38

Russian River Valley Two Acres Proprietary Red Wine 2004

93 points. This effort is an example of a California wine that tastes like it came from a vineyard overlooking the Mediterranean. Made from 90-year-old mourvèdre vines, it also has varieties such as valdepenas (often found in Spain), petite sirah, and Alicante Bouschet. \$38

Russian River Valley Carlo's Ranch Zinfandel 2004

91 points. This is an unfiltered, full-throttle zinfandel from 70-year-old vines. The wine generally possesses a dark purple color, superb acidity, and a delicate yet powerful style. The alcohol



OFFICER
From
software
to syrah



**FRUITY
ZINFANDEL**

level is high, in the 15%-to-16% range. \$38

Bennett Valley Judge Family Vineyard Syrah 2004

95 points. This blockbuster boasts meat, lard, blackberry, and flower aromas, an opulent, voluptuous, full-bodied personality, and a juicy, succulent finish. Enjoy it over the next decade. \$40

NOT YET RELEASED:

Dry Creek Valley Bacchi Ranch Zinfandel 2005

91 points. Even with 16%-plus alcohol content, this wine is elegant, offering

notes of minerals, flowers, licorice, pepper, and red and black fruits.

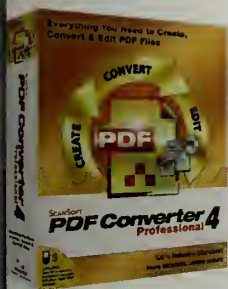
Dry Creek Valley Gold Mine Ranch Zinfandel 2005

91 points. One of the smaller production cuvées, this wine is from an organically farmed vineyard planted in 1914. With a touch of carignane in the blend, this whopper reveals a pinot noir-like complexity along with superb acidity and a distinctive earthiness.

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see the list of thousands of tasting notes, buy his books, subscribe to his newsletter, The Wine Advocate.

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/ext

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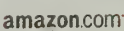
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Financial Pedigrees— Or Blarney?

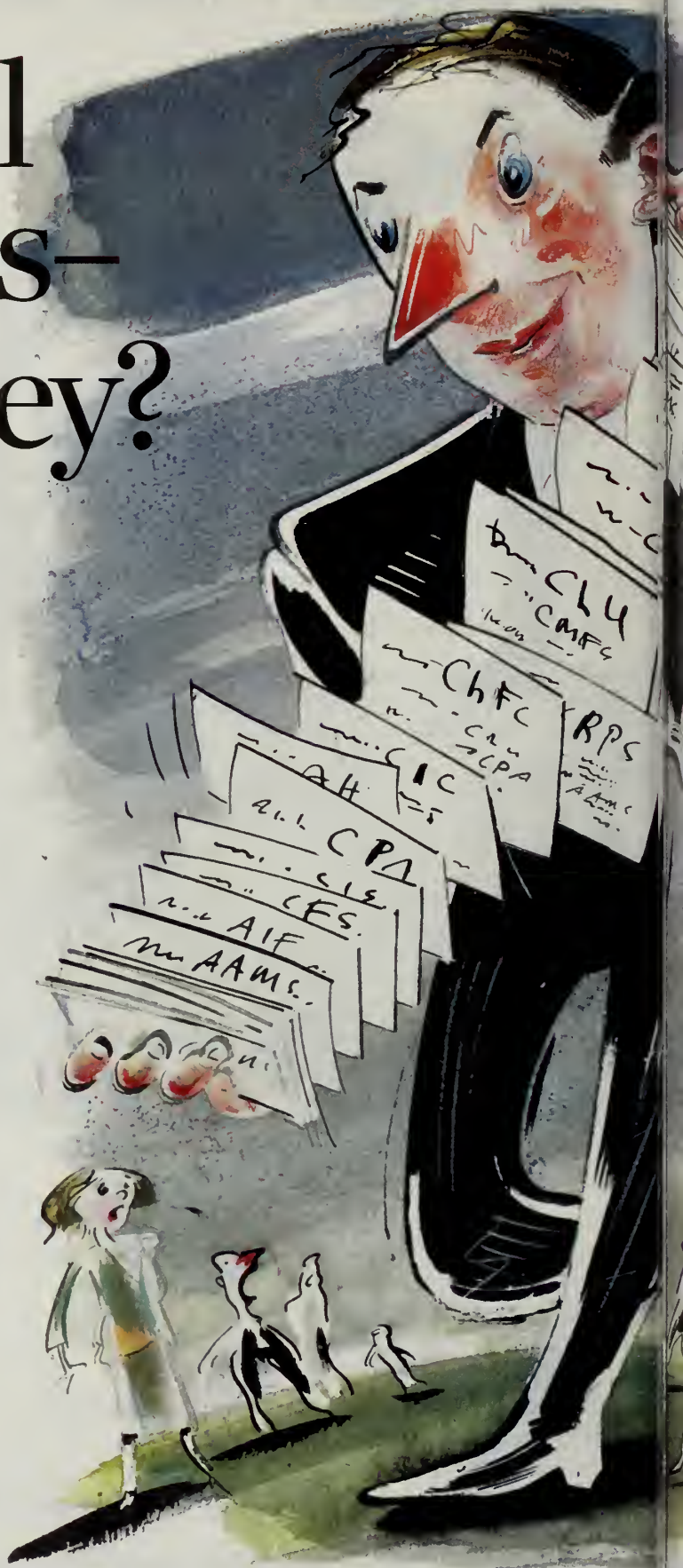
A guide to decoding the dizzying array of acronyms on your adviser's business card.

BY LAUREN YOUNG

NEXT TIME YOU sit down with a financial adviser, make sure you bring along a bowl and a spoon. You may need them to get through the alphabet soup of acronyms on the adviser's business card. In addition to standard accreditations such as Certified Financial Planner (CFP) and Chartered Life Underwriter (CLU), there's a new crop of titles that cover specialties such as advising senior citizens, choosing alternative investments, and investing with Christian values.

Overall, the financial-services world boasts nearly 90 designations, titles, degrees, affiliations, certifications, and accreditations, some of which require little more than a check to obtain. "With college degrees, there are diploma mills. There is the absolute equivalent with financial certification," says Jack Waymire, author of *Who's Watching Your Money* and founder of the Paladin Registry (paladinregistry.com), which helps investors find advisers.

The proliferation of acronyms has caught the eye of state regulators, particularly for designations aimed to impress senior





citizens. During the past two years states shifted their focus to financial credentials such as Certified Senior Advisor (CSA). The CSA designation requires a three-day course administered by the Society for Certified Senior Advisors, a Denver company that started offering the credential in 2004.

Plenty of other designations are aimed at providing expertise to investors 55 years and older, including Certified Senior Consultant (CSC), Certified Senior Specialist (CSS), and Chartered Senior Financial Planner (CSFP). With so many to choose from, "these senior-vintage designations are confusing and may even be deceptive," says Wisconsin Securities Administrator Patricia D. Struck, who is past president of the North American Securities Administrators Assn., an investor protection group.

In Nebraska, the state's Bureau of Securities issued a special notice on Jan. 1 to all federally covered and state registered investment advisers requesting that "firms prohibit the use of all professional designations that state or imply a specialized knowledge of the needs of senior investors by their...investment adviser representatives registered in Nebraska." Says Jack Herstein, assistant director of Nebraska's Finance & Banking Dept.: "There are some legitimate designations like the CLU, which take three years of study to complete, but others do it in one weekend," adding that "we are trying to weed out which designations represent meaningful achievement and which are plain marketing tools." While Herstein would not single out any particular credentials as bogus, he says complaints from seniors about bad or deceptive investment advice have led to at least 60 investigations during the past two years, a significant increase.

(On Feb. 5 the organization that oversees the CSA added new language in its code of conduct to let the group notify regulators if persons who use the CSA designation are not CSAs in good standing. The CSA designation isn't limited to financial types. Among the 13,000 with it are funeral directors, elder law attorneys, and health-care administrators.)

The value of an adviser's credentials is hard to compare when each designation has its own requirements. Brokerage licenses are overseen by the NASD, the private-sector regulator of the U.S.'s securities industry. But no such watchdog

exists for the panoply of financial planning groups.

Even so, several factors seem to distinguish a meaningful designation from a framed certificate. Financial experts agree that the most substantial designations require significant educational coursework, testing, rigorous continuing education requirements, a code of ethics, and a governing body that has the power to remove the bad apples.

BACK TO SCHOOL

OF ALL THE FINANCIAL planning designations, the one that carries the most clout is Certified Financial Planner. Even brokerage firms are recognizing its value. Last year, for instance, A.G. Edwards & Sons Inc. launched an internal campaign to get more of its financial consultants to earn a CFP certification. "It allows you to be a better steward for your client," says John Hagedorn, vice-president and manager of continuing education at the firm. The goal is to have 1,200 CFPs among its 5,600 brokers by the end of this year.

In addition to the amount of time it takes to earn a title, the requirements to maintain it are key. If you have complicated taxes, you want an adviser who is up to date on the tax code. Yet continuing education requirements run the gamut from 60 hours every two years in six core areas (National Association of Personal Financial Advisors) to no continuing ed (Chartered Alternative Investment Analyst). Ask your adviser about ongoing coursework.

Of course, vetting an adviser strictly by titles and education is not enough. What fancy titles won't help you determine is the quality and breadth of an adviser's expertise. "In our more-is-better society, there is a risk that a person seeking advice will believe a string of credentials establishes excellence," says Kathleen Hartman, a financial adviser at Greenleaf Financial in Indianapolis.

Although you won't find a general consensus on which designations are the best or the worst, some add more weight to an adviser's business card. You need to be the judge on whether the initials beside an adviser's name confer quality or quackery. ■

BusinessWeek .com

ONLINE: For a list and more details on noteworthy financial designations, go to www.businessweek.com/extras.

Fidelity's Trade School

Its online Knowledge Center offers bite-size lessons—and anyone can attend. **BY AARON PRESSMAN**

OVER THE PAST FEW years, online brokers have been one-upping one another with sophisticated teaching tools and services to lure active traders—those who make at least 10 trades a month—and their bountiful commissions. The average, or should we say not-so-active, investor could also benefit from learning about such things as risk management methods for protecting a portfolio against a market crash. But it's not easy to find these offerings on many sites, and sometimes they're even walled off from all but premium customers.

Not so at Fidelity Investments' site. Its new educational effort, dubbed the Trading Knowledge Center, takes some big steps in bringing this sort of info to the masses—you don't even have to be a customer. The advice is solid, the graphics cutting-edge, and the terrific-looking video tutorials deliver sometimes arcane material in easy-to-digest pieces. What was that again about protective put options? Click to replay the video or call up the transcript.

You can link to the Knowledge Center from the home page of fidelity.com. The best door is the button on the upper right, which will launch a new window. From there, you can watch the Beginners Guide video or jump right into the modules. You don't need to visit Platforms and Tools unless you plan to become a Fidelity customer or step up to its programs reserved for active traders. But almost everyone can benefit from clicking into Strategies and Insights.

EASY TO NAVIGATE

EACH MODULE CONTAINS links to well-produced short videos, typically three to four minutes in length. Narrated by professional actors and market experts, they're a cut above most video on the Internet. The advice and explanations run the gamut from the incredibly basic ("options are contracts between a buyer and a seller") to the nitty-gritty of complex trading strategies ("the classic whipsaw scenario in which a short, sharp price reversal stops you out").

You'll find the basics and lots of in-depth info

Right now, the Strategies and Insights section covers four areas: technical stock market analysis, fundamental company analysis, options trading, and risk management. Two of them offer a choice either basic or advanced material. For instance, there's the Introduction to Fundamentals and a more in-depth discussion of earnings that takes you deeper into how companies report them—GAAP (general accepted accounting principles), basic, operating, and pro forma.

Each such section is called a module and Fidelity says it plans to add up to 30 a year in these four and perhaps a few additional subject areas.

Navigating the site is a snap. Besides the video and transcripts in each module,

you can link to further readings, definitions, and in-depth articles on the same topics produced by Standard & Poor's (like *BusinessWeek*, a unit of The McGraw-Hill Companies.)

One shortcoming: The Knowledge Center is light on expert talking heads offering insights that go beyond the basics of how these indicators work. The area on technical analysis has four, but earnings, for instance, has only one—Jonathan Keri, assistant markets editor at *Investor's Business Daily*. Surely, there are others who can rip apart earnings statements.

It would be great to watch videos with Fidelity luminaries such as Peter Lynch and Will Danoff, manager of Fidelity Contrafund. Fidelity says that, to maintain the objectivity of the Knowledge Center, it won't use its own investment professionals.

It's hard to imagine that anyone would object to some real-world wisdom from Lynch or his compatriots. Still, the Knowledge Center has a strong start, and it's a destination you'll want to visit to pick up some pointers or brush up your skills. ■

Answers for the Average Investor



LOOK AND LISTEN Well-scripted lessons are delivered by professional actors and supported by crisp graphics. To review a point, replay the video or read the transcript.

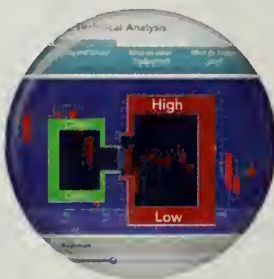
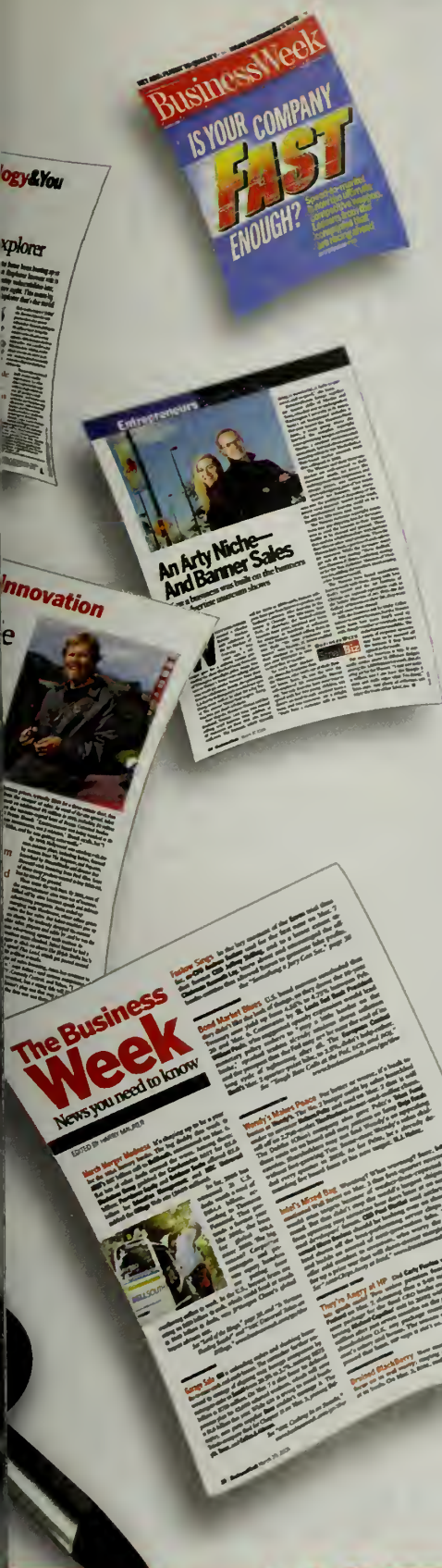


CHART READING Traders need to know how to interpret charts, such as this one from Introduction to Technical Analysis that zooms in on a stock's highs and lows.

PLOT IT OUT Concepts such as trailing stop losses are illustrated with easy-to-follow schematics. This comes from the risk management section.





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Bond Funds for Turbulent Times

With corporate bonds headed for rough waters, now is the time for a portfolio checkup. **BY DAVID HENRY**

ARE YOUR BOND FUNDS the right ones to carry through treacherous conditions? By many historical measures and anecdotal evidence, the corporate bond market is at or near highs and at risk of falling. Private equity firms are trashing corporate credit quality through leveraged buyouts. And though not an immediate threat, a spike in long-term interest rates is always a possibility. That would mean lower bond prices. ⚡ Bailing out of bonds is not the answer. As a constant part of your portfolio, say 30 or 40%, well-chosen and diversified bond funds provide valuable comfort against the unnerving volatility and losses that sweep

the stock market, says financial planner Kurt Brouwer, co-founder of Brouwer & Janachowski in Tiburon, Calif. Here are some answers to the questions you should be asking as you do a portfolio checkup:

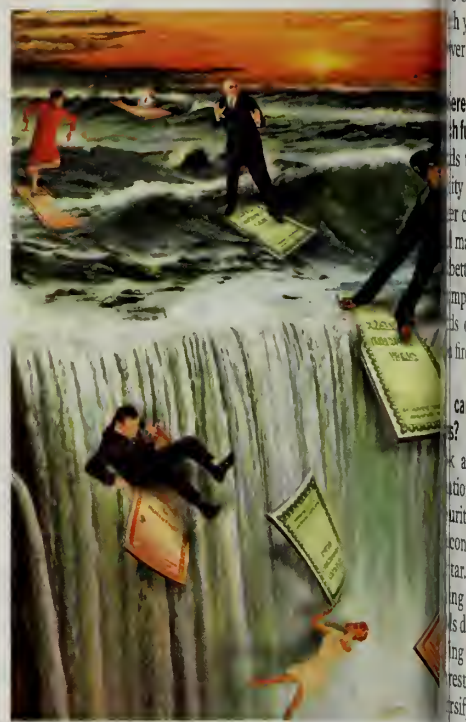
Are all investment-grade funds alike?

No. Some funds, to juice their yields, buy a lot of corporate bonds rated triple-B. That's the lowest investment-grade rating. Triple-Bs are especially vulnerable to price drops because many institutional investors have to sell them if they slip to junk status.

Should I own some junk-bond funds because of their higher yields?

Probably, but with caution. Their bonds tend to have covenants that limit how much additional debt issuers can take on—so on that count, they're safer than investment-grade bonds. That's still true even now as covenants in recently issued bonds have given more leeway to borrowers than in the past. And, if interest rates rise because of a stronger economy, junk bonds will benefit from improving credit ratings.

The reason to be cautious is that junk



credit premiums, the extra yield they offer over default-free Treasuries, are at record lows of about 2.5 percentage points. That may not be enough to cover losses from defaults pick up. Last year only 1.39

is defaulted, vs. the 4.7% historical average, according to Standard & Poor's.

with credit premiums so low, why would I take the risk on defaults going to the long-term average?

of experts said the same thing in 2004. But staying out of junk then would have meant missing some great returns. Annualized returns for the three years ending in December were 8.4%, more than twice the 3.7% from investment-grade, notes Zane Brown, director of fixed income at Lord Abbett. They're held in tax-deferred accounts since most of their return is interest income.

One solution is to let a professional manage the junk market for you. Robert Rodriguez, manager of FPA New Income for the past 23 years, will put as much as 5% of assets into junk bonds when he's convinced they're cheap, as he did 18 months ago. He has sold almost all of them now. Another answer is to go with junk and with a lot of the better junk, the investment-grade bonds, the "crème de la crud," says Brown. Avoid funds with lots of CDO paper.

Some managers, such as Raymond G. Kelly of PIMCO High Yield, have improved the credit quality of their portfolios by buying more corporate loans, which yield slightly less than bonds but recover more if borrowers default.

Where were a rout in the junk market, which funds would fare best?

Funds that hold bonds of better credit quality and those with bonds issued by investment-grade companies would be safer bets. A manager would be able to sell those bonds at better prices to raise cash to meet redemptions from investors turning tail. Funds of smaller companies might only recoup fire-sale prices.

Can I guard against higher interest rates?

At the funds' average effective duration, a more refined measure than maturity. Durations of 3.5 to 6 years are considered intermediate by Morningstar. If duration is longer, you're seeing more stock-like volatility. Good funds disclose their durations. To avoid getting stuck by a fund manager's bad investment-rate call, Brouwer recommends diversifying with two or three funds having different durations, such as Fidelity Total Return, with a duration of 5 years, and FPA New Income, with a duration of 3.9 years. He also likes Western Asset Plus Bond fund, with a recent duration of 3.9 years. ■

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BY GENE G. MARCIAL

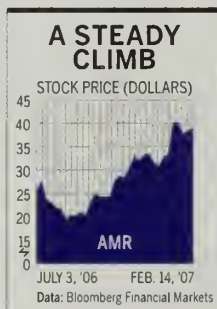
GOLDMAN SACHS AND BRITISH AIRWAYS ARE CIRCLING AMR.

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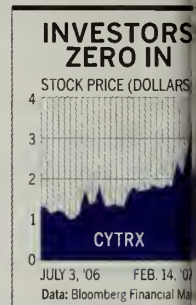
AIRLINE CONSOLIDATION hasn't stopped despite US Airways' failed run at Delta Air Lines. "It's not over," says Ray Neidl of Calyon Securities, and mergers and acquisitions should heat up soon. The buzz: AMR, parent of No. 1 American Airlines, is a buyout target of a group that includes Goldman Sachs and British Airways, say people familiar with the matter. In private discussions, the proposed bid is said to be between 46 a share, or \$9.8 billion, and 52, or \$11.1 billion. AMR now trades at 38.57, or \$8.2 billion. It's uncertain a deal will materialize, the sources say. Foreign airlines are limited to a 25% stake in U.S. carriers. "I wouldn't be surprised," says Jim Corridore, airline analyst at Standard & Poor's, if private buyers were eyeing AMR. It has a market cap of \$8 billion, with \$23 billion in revenues and a \$6 billion cash hoard. Of course, he adds, AMR also has labor issues, \$18 billion in debt, and underfunded pension liabilities. Both Goldman and British Airways said they didn't comment on speculation. AMR's Tim Smith said: "We talk to lots of people, but until discussions result in anything of substance, we simply do not comment." Wall Street looks at airlines more favorably now because of stronger demand and lower fuel costs. And AMR, serving 150 cities worldwide, excels in efficiency and has huge free cash flow. "With oil prices at \$58 a barrel, AMR will spend \$850 million less for fuel in 2007 and will generate \$2.3 billion in free cash," figures Kevin Crissey of UBS, which has done banking for AMR. He rates the airline a buy, with a 12-month target of 54. Crissey has hoisted his 2007 earnings forecast from \$4.46 to \$6.12 a share, vs. 2006's \$1.43 (before charges).



CytRx Can 'Silence' Genes that Cause Disease

SINCE OCTOBER, shares of CytRx (CYTR) have more than doubled, from 1.50 to 3.50 on Feb. 14 as investors zeroed in on its RNA interference technology (RNAi) that targets diabetes, obesity, and ALS (Lou Gehrig's disease). RNAi effectively interferes with the power of diseased genes. "RNAi's ability to silence genes could provide a new way to treat a wide range of human diseases," says Chrystyna Bedrij of Griffin Securities, who rates CytRx a buy. "RNAi technology

is hot for two reasons," says Elemer Piros of Rodman & Renshaw, who pegs CytRx "outperform." First, Craig Mello, professor of molecular medicine at University of Massachusetts Medical School, joined the CytRx scientific board in January. Mello co-discovered RNAi in 1998—and won the Nobel Prize for it in 2006. Second, Merck paid \$1.1 billion in 2006 for Sirna Therapeutics, which is developing therapy for diseases such as hepatitis using RNAi. Merck's buy was seen as a validation of RNAi—and of CytRx' focus on RNAi. Piros says: "If CytRx succeeds in its RNAi tests for humans, scheduled in 12 to 18 months, the stock could double if not triple."



Microvision's Gleam Lights Up a Big Screen

HOW ABOUT A CELL PHONE embedded with a tiny projector that displays an image the size of a laptop screen or as big as a plasma TV? Microvision (MVIS), which develops high-resolution displays and imaging systems, unveiled a prototype of such a device in January at the Consumer Electronics Show in Las Vegas. Corning and Novalux developed the green lasers incorporated into Microvision's ultra-thin, miniature, full-color projection displays, says CEO Alexander Tokman. He is in talks with the major cell-phone makers for partnership deals. "The mini projectors created tremendous buzz," says Peter Conley, managing director at MDB Capital Group. "The market for the laser-based displays in micro form is huge, as the cell-phone market is still basically untapped," he says. Joel Achramowicz, an analyst at MDB Capital, rates the stock a buy and expects Microvision to partner with a handset maker by summer. He sees the stock now trading at 3.16, doubling in a year. ■



BusinessWeek .com

ONLINE: Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursday. **Note:** Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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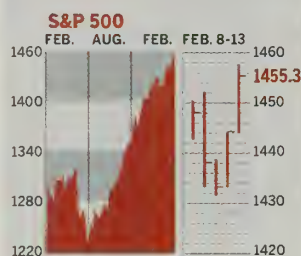
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STOCKS



COMMENTARY

After slipping early in the week, the markets finished strong. Soothing testimony by Fed Chairman Bernanke helped, as did other good news from General Motors, via an upgrade by Merrill Lynch. Deere increased its sales and profit forecast, sending shares soaring 8.1%. And the prospect of a takeover of Alcoa sent the stock up 7.5%.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED FEB. 13

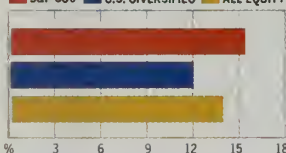
■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



52-WEEK TOTAL RETURN

WEEK ENDED FEB. 13

■ S&P 500 ■ U.S. DIVERSIFIED ■ ALL EQUITY



Data: Standard & Poor's

U.S. MARKETS

	FEB. 14	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1455.3	0.4	2.6	14.1
Dow Jones Industrials	12,741.9	0.6	2.2	15.5
NASDAQ Composite	2488.4	-0.1	3.0	10.0
S&P MidCap 400	855.5	0.6	6.4	11.8
S&P SmallCap 600	415.1	-0.3	3.8	11.9
DJ Wilshire 5000	14,659.1	0.2	3.1	14.4

SECTORS

	FEB. 14	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	822.8	0.5	3.0	9.5
BW Info Tech 100**	450.4	0.0	0.7	17.1
S&P/Citigroup Growth	666.1	0.2	2.1	10.2
S&P/Citigroup Value	788.0	0.5	3.1	18.1
S&P Energy	451.8	0.8	-0.8	16.9
S&P Financials	506.5	0.0	2.3	17.3
S&P REIT	219.1	-2.6	10.2	34.7
S&P Transportation	281.6	3.8	6.8	7.4
S&P Utilities	194.5	1.4	4.2	21.3
GSTI Internet	209.7	2.0	5.0	7.4
PSE Technology	906.5	0.2	3.5	4.2

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	FEB. 14	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2068.9	1.1	4.0	2.1
London (FT-SE 100)	6421.2	0.8	3.2	1.1
Paris (CAC 40)	5725.8	0.4	3.3	1.1
Frankfurt (DAX)	6961.2	0.7	5.5	2.1
Tokyo (NIKKEI 225)	17,752.6	2.7	3.1	1.1
Hong Kong (Hang Seng)	20,209.9	-2.3	1.2	1.1
Toronto (S&P/TSX Composite)	13,204.5	0.5	2.3	1.1
Mexico City (IPC)	28,539.7	1.5	7.9	5.1

FUNDAMENTALS

	FEB. 13	WEEK AGO	YEA
S&P 500 Dividend Yield	1.76	1.75%	1.7%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	18.0	1
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.4	1
First Call Earnings Surprise*	5.26%	5.11%	3.20%

*First C

TECHNICAL INDICATORS

	FEB. 13	WEEK AGO	YEA
S&P 500 200-day average	1337.0	1333.6	Posit
Stocks above 200-day average	80.0%	80.0%	Negat
Options: Put/call ratio	0.76	0.82	Posit
Insiders: Vickers NYSE Sell/buy ratio	6.27	5.82	Negat

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Constr. Materials	20.1	65.4
IT Consulting	15.1	64.4
Steel	14.8	47.1
Automobiles	13.7	45.7
Industrial REIT's	13.4	43.2

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Motorcycles	-5.3	Education Services
Systems Software	-5.2	Electric Mfg. Svcs.
Casinos	-4.7	Homebuilding
Metal & Glass Containers	-3.7	Gold Mining
Environmental Services	-3.6	Semiconductors

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LAGGARDS		LAGGARDS	
Latin America	7.2	Real Estate	37.9
Natural Resources	7.0	Latin America	34.3
Precious Metals	6.4	Pacific/Asia ex-Japan	33.0
Real Estate	6.2	Europe	28.8
LAGGARDS		LAGGARDS	
Technology	-1.1	Japan	1.4
Large-cap Growth	0.2	Technology	4.8
Health	0.7	Health	5.6
Domestic Hybrid	1.1	Small-cap Growth	7.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LAGGARDS		LAGGARDS	
DireXn. Cmty. Bull 2X	17.4	Dreyfus Prem. Grtr. China A	68.4
DireXn. Lat. Am. Bull 2X Inv.	13.0	Oberweis China Opport.	58.3
ProFunds Oil Equip., Svcs.	12.2	Old Mut. Clay Finlay Ch. A	58.2
ProFunds Precs. Mtls. Inv.	10.6	ProFunds Real Est. Inv.	57.6
LAGGARDS		LAGGARDS	
DireXn. NASDAQ 100 BL 2.5X	-8.6	DireXn. Emrg. Mkts. Short	-38.9
ProFds UltSh. Emrg. Mkts. Inv.	-8.0	DireXn. Dev. Mkts. Bear 2X	-33.8
ProFds. Sh. Prec. Mtls. Inv.	-6.8	DireXn. Sm. Cap Bear 2.5X	-27.0
Rydex Dynamic OTC H	-6.8	American Heritage Grth.	-25.0

INTEREST RATES

KEY RATES

	FEB. 14	WEEK AGO	YEA
Money Market Funds	4.86%	4.86%	4
90-Day Treasury Bills	5.15	5.15	4
2-Year Treasury Notes	4.87	4.87	4
10-Year Treasury Notes	4.74	4.74	4
30-Year Treasury Bonds	4.83	4.85	4
30-Year Fixed Mortgage†	6.19	6.17	6

†BancQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.88%	4.2
Taxable Equivalent	5.54	6.0
Insured Revenue Bonds	4.02	4.5
Taxable Equivalent	5.74	6.4

THE WEEK AHEAD

CONSUMER PRICE INDEX

Wednesday, Feb. 21, 8:30 a.m.

EST » Consumer prices are forecast to have edged up by 0.1% in January, after posting an energy-influenced rise of 0.5% for December. That's according to the consensus estimate among economists queried by Action Economics. Excluding energy and food, the prices very likely climbed by 0.2% for a second consecutive month.

LEADING INDICATORS

Wednesday, Feb. 21, 10 a.m. EST » The Conference Board's January leading economic indicators index most likely grew an additional 0.2%, following a 0.3% gain in December. The index will get a bounce from brighter consumer expectations, a small increase in stock prices, and fewer initial jobless claims.

FOMC MINUTES Wednesday, Feb. 21, 2 p.m. EST » The Federal

Reserve's Open Market Committee releases the minutes to its two-day monetary policy meeting on Jan. 30-31. Fed watchers will peruse the text for more clues on how hawkish the central bankers are about potential price pressures. The notes may also contain some information on the Fed's conversation about communication issues, which include inflation targeting and economic forecasts.

The BusinessWeek production index grew to 293.3 for the week ended Feb. 3, an 8.6% gain from a year ago. Before calculation of the full week moving average, the index jumped to 294.4.

BusinessWeek .com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

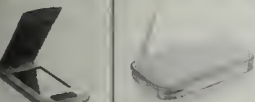
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Turning Ideas into Dollars

PAYBACK Reaping the Rewards of Innovation

By James P. Andrew and Harold L. Sirkin; Harvard Business School Press; 228pp; \$29.95

You're a pretty sharp executive. But maybe your company is suffering from slowing sales growth. Perhaps margins are getting squeezed. Or new competitors are stealing market share and talent. What do you do? Innovate, of course. **J**In Corporate America, acquisitions and cost-cutting are

yesterday's strategies. Today, innovation is in. In a Boston Consulting Group Inc. poll of senior managers in 2006, 81% of chief executives listed innovation as one of the top three priorities at their companies. Further, 76% of CEOs told the BCG survey, done annually in partnership with *BusinessWeek*, that their corporate cultures foster innovation.

Despite their zeal, though, many companies come up short when it comes to innovation, observe veteran BCG consultants James P. Andrew and Harold L. Sirkin in *Payback: Reaping the Rewards of Innovation*. Typically, it's not because these companies lack smart ideas. It's that they don't manage to turn that winning concept into a winning product. "Most attempts at innovation fail to...generate enough payback," the pair write. "Payback means one thing—cash."

To better these returns, Andrew and Sirkin offer a step-by-step program for upper-level executives. Organized like a consultant's presentation—the authors are, after all, senior vice-presidents and directors at BCG—their advice is easy to grasp. Their book is also quick to read: You could probably breeze through the 22-page overview while the coach-class passengers file past to take their seats and be wrapping up the afterword before your flight from New York lands in Chicago.

The authors' main point is never to forget that innovation is only a means to make money. There are indirect benefits from innovation, of course, such as boosting morale and enhancing brand image. But unless innovation equals profit, it's not worth it. To see this plainly, Andrew and Sirkin urge executives to plot a cash curve. The chart measures four so-called S factors: startup costs, or prelaunch investments; speed, or development time to get to market; scale, or time to ramp up to peak volume; and support costs, which include marketing and cannibalization of earlier products.

Ideally, the curve follows the lifeline of Apple's iPod. Certainly, design played a huge role in the product's dazzling

success. Overlooked, argue the authors, was Apple's expertise in minimizing outlays and maximizing income. Apple kept its startup costs down, for example, by contracting out engineering work. As a result, Apple never had more than 50 employees on the iPod project team. By again turning outside help, the company also hurried along the iPod's development and ramp-up of production, hitting the market with ample supplies just before Christmas, 2001. All told, the authors estimate, Apple spent \$10 million to develop the first iPod. Through 2005, they reckon, iPod-related sales came to more than \$7 billion.

More often than not, however, the cash curve looks like the chart for Motorola's Iridium phone network. Motorola wisely joined together a consortium of partners to share the \$5 billion it cost to start its new service, which included the launch of 66 low-orbiting satellites. But there was no speed to market: it took 12 years to get from concept to reality. By then, mobile-phone networks had already won over many of Iridium's hoped-for customers, and at prices well below Iridium's. The venture went bankrupt in 1999.

"More than 30 years ago," say Andrew and Sirkin, "Bruce Henderson, founder of BCG, wrote, 'The majority of products in new companies are cash traps—they will absorb more forever than they will generate.' This is still true today."

Payback needs more how-to instructions.

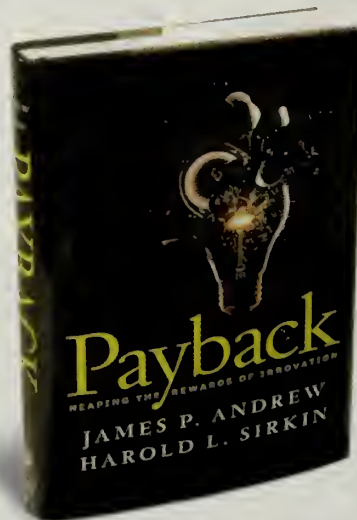
Yes, the cash curve is, as the authors say, "a case where a picture is worth more than a thousand words—it may be worth \$100 million or more." But how to draw that curve when there are countless data points and every one is only a best guess? The book could use more hard numbers. At LG Electronics, for instance, when the authors observed innovative teams, an executive related how many projects were under way

The authors insist that innovation is pointless unless it leads to profit

(200) and how many were likely to have a big impact (10 to 20). But there are no figures on how much even one of LG's innovations cost or generated in sales or profit.

Based on its own cost curve, however, the book should put readers ahead. The up-front investment is minimal, and there's little time expended from start to finish. There's ample payback in being reminded that innovation is likely to be no more of a fix-all than management fads of the past.

—By Michael A.



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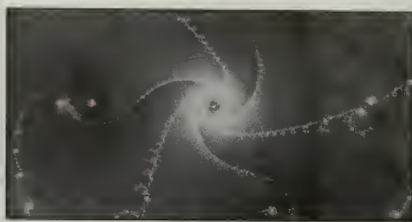
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Will Dell Be a Comeback Kid?

AFTER PUSHING OUT Kevin Rollins as CEO and grabbing the reins of Dell Inc. himself, Michael Dell has set about reviving the fortunes of the company he founded. He hired former AMR CEO Don Carty as CFO, and he has now brought in Solectron CEO Michael Cannon as president of global operations. Will Dell be a comeback kid?

You are taking back the company as CEO. How does it feel?

It's very exciting. I am 41 years old...and I believe there is a whole lot we can do. I have outlined some near-term priorities. We are looking to expand services. We are likely to do more internationally. We are looking at the next billion PC users [in emerging markets]. In about five or six weeks, I'll be in China to launch a special new product that appeals to the inexperienced PC user.

What can you do that your last CEO couldn't do?

Kevin [Rollins] was with the company for 10 years, and during that time, it grew from \$5 billion in revenues to \$57 billion. I was CEO for most of that time, and he was CEO for 2½ years. I don't want to minimize his contributions because he did a lot and he is still a friend, but it was time to make a change.

What went wrong with Dell?

In the fourth quarter of last year, in the consumer market in particular, we lost share, and I think it's due to a number of factors. There are things we can address in terms of product innovation...and the customer experience. There has been huge growth in international markets, some of which we haven't been participating in much. Dell has been skewed to the U.S. in a big way, and knowledgeable computer customers were reluctant to buy right before the Vista upgrade.

What is the right revenue growth people should expect?

It will take about 18 months to effect the changes...but we are not providing guidance on growth or profitability.

Do you have to make a big acquisition to participate in the growth overseas?

[With new factories in China,] Brazil, Poland, Russia, Central Europe, we don't have to do a big acquisition. But it doesn't mean we won't consider one.

What about printers? You said you'd make a big splash and go against Hewlett-Packard, and, frankly, you haven't done well. We have built a little more than a \$1 billion printer business, which is pretty good.... We can continue to grow.

Dell was hit by a big lawsuit from [plaintiffs' attorney] Bill

Lerach's firm alleging that Dell executives sold off \$3.3 billion of stock before the company began its slide in 2005. Lerach calls it the worst case of "dump and run" we have seen, both in terms of the scale of the stock sales and the fact that many top execs sold more than 90% of their Dell holdings [Rollins sold over 95%, and Dell sold 22%]. How do you respond?

We don't comment on pending litigation.

A key Lerach claim is that Dell headed south after it stopped getting a \$250 million-a-quarter

payment from Intel for exclusively sticking with its chips. The lawsuit claims Dell deceived shareholders by not disclosing the payments and using them to prop up the story that the direct sales engine was still in great working order.

Again, I can't comment, but I will say that it's in the company's best interest to negotiate the best terms with suppliers, and that is something any company would do.

Dell is in the penalty box with investors right now. For how long?

It took us some time to get into these challenges, and it will take us some time to get out. I think we have some tough negotiations and some tough quarters ahead.

Earlier you said 18 months.

I think 18 months is a good timeline to think about.

Did you wait too long to come back?

I am not sure.

Maria Bartiromo is the anchor of CNBC's Closing Bell.





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Ideas **The Welch Way**

BY JACK AND SUZY WELCH

The Global Warming Wager

Virtually every scientist agrees that global warming is destroying our planet. But I've heard you suggest that the verdict is still out. You can't actually feel that way, can you?

—Heidi Boncher, New York

In general, we tend to have a “not so fast” attitude when any controversial topic is part of the juggernaut of a political party's agenda. The state of the U.S. economy is a case in point. Democrats claim it's weak and its benefits uneven. The Republicans claim it's booming with broad income improvement. Or take the war in Iraq. Some Democrats claim we've been defeated and need to withdraw; many Republicans say victory is within reach, and a troop surge is our best and final chance for a free Iraq. With each of these hot-button topics, the debate is less about facts and more about party lines, President Bush, and the election of 2008.

And so it goes with global warming. Yes, a recent report from the Intergovernmental Panel on Climate Change is worrying, both for what it says about the causes of global warming and its environmental impact. That story, ominous in tone, played as the lead on the front page of *The New York Times*. But within days, a *Wall Street Journal* editorial asserted that the document's underlying scientific findings actually suggest that global warming is hardly the apocalypse. Indeed, the *Journal* opined, some new scientific data in the report indicate all the sound and fury about global warming could end up being...well, just that.

So, to your question then, what do we believe? You sensed right—we simply don't know. But that doesn't mean we would recommend companies do nothing. Just the opposite. In fact, we believe that, whether the impact of global warming ends up being mild or severe, companies have to adopt a “here it comes” mind-set and mount a well-reasoned plan. Any other response would be bad business.

Our reasoning is hardly original. It's the same as Pascal's Wager. Back in 1670, basically using game theory, the French philosopher argued that it was a better bet to believe in God because the expected value of believing is always greater than the expected value of not believing.

The same goes for global warming. If you accept it as reality, adapting your strategy and practices, your plants will use less energy and emit fewer effluents. Your packaging will

be more biodegradable, and your new products will be able to capture any markets created by severe weather effects. If global warming may not be as damaging as some predict, and you might have invested more than you needed, but it's just as Pascal said: Given all the possible outcomes, the upside of being ready and prepared for a “fearsome event” surely beats the alternative.

The perfect analogy is globalization. Thirty years ago, rumbling began about the coming world marketplace where costs would migrate to the lowest bidder. Some companies put on blinders and insisted that their quality would prevent competition from the likes of Mexican and Asian factories. Eventually, of course, many of these companies got religion and changed their practices. But years of progress, profits, and jobs were lost in their delay.

Only time will tell if global warming will be minor or catastrophic; if it can be mitigated or will destroy the planet to use your phrase. But one thing is certain. Companies shouldn't wait to find out.

Most of us in the corporate world have to deal with a yearly review, and we hate it. How about just letting employees know when they are performing way under or way beyond expectations? That would save companies a lot of wasted time. Is it a good idea?

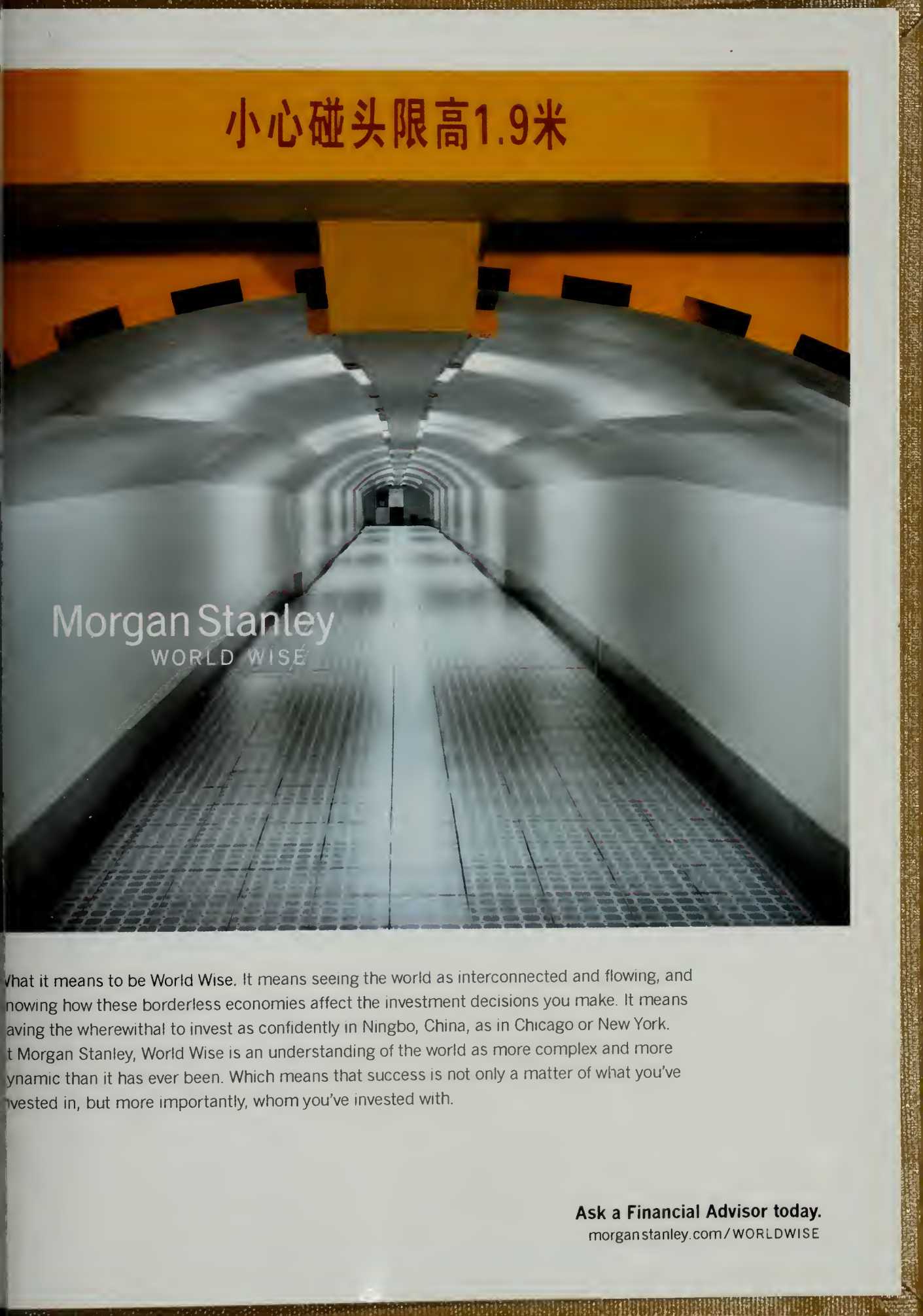
—Haihui Niu, Naperville, Ill.

With all due respect, we think it's a terrible idea! Look, companies can't win without great people, and you can't develop great people without performance appraisals. Now, we're not talking about elaborate forms and piles of paperwork. That's way too bureaucratic. All managers need to do is sit down with each direct report and share with him or her a single page that says: “Here's what you do well,” and “Here's what you can do better.” And that should happen not once a year but—brace yourself—three or four times, particularly with every raise, bonus, or promotion.

We've said in this column before that managers have many jobs. In the question above we've even added preparing for global warming to the list. But at the end of the day, almost no managerial responsibility trumps building the best team. And to do that, you can't just connect with the outliers. Everyone needs to know where he or she stands, and often

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast go to www.businessweek.com/search/podcasting.htm.

Is the planet headed for an apocalypse? Hard to tell. But heeding Pascal is the best bet



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